Well at Walgreens

Walgreens

2011 Annual Report

Well
at Walgreens

defines what we want customers to experience.

Live well by finding value, fun and solutions for their daily needs.

Stay well by finding the right products for health and daily living.

Get well when they feel ill.

About the Cover
Alana Bowman and her daughter Sadie in Brandon, Mississippi, enjoy their time together at a local playground. “As a single mom with a full-time career, I’m always looking for ways to save time and money,” she says. Taking advantage of the multiple ways she can access Walgreens, Alana shops Walgreens.com, drugstore.com and Beauty.com websites to find great values on products she regularly uses, like shampoo, cosmetics and contact lens solution. She also visits her local Walgreens for family needs such as prescriptions, school supplies and over-the-counter medications.

2011 Milestones

- Walgreens is the nation’s largest drugstore chain, with fiscal 2011 sales of $72.2 billion and record profit of $2.7 billion. The Company has 247,000 employees.
- This is the Company’s 37th consecutive year of record sales. It’s also the 36th consecutive year Walgreens has raised its quarterly dividend – paid every quarter since 1933.
- The Company returned $2.4 billion to shareholders through dividends and share repurchases in fiscal 2011, and announced its largest dividend increase ever of 28.6 percent in July, as well as a new $2 billion share repurchase program.
- Walgreens filled a record 819 million prescriptions in fiscal 2011 – one in five retail prescriptions in America. Pharmacy is 65 percent of the Company’s business.
- Advancing its leadership in providing flu shots, Walgreens delivered 6.4 million flu shots last year as the Company continued to serve as the country’s No. 1 provider of flu shots other than the federal government.
- To expand the role Walgreens plays in health care, the Company established important new alliances with top health systems, including Johns Hopkins Medical Center, Ochsner Health System and Louisiana State University, to enhance coordinated care to patients.
- The Company completed its goal set in 2009 to convert or open 5,500 Walgreens stores with its new “Customer Centric Retailing” format, which offers customers a more targeted product assortment, better sight lines and new décor packages.
- Walgreens completed its acquisition of drugstore.com, extending its multi-channel reach to an additional 3 million online customers, forging relationships with new vendors and partners and adding approximately 60,000 health, personal care and beauty products to its online offering.
- The Company announced plans to open or convert at least 1,000 “food oasis” stores over the next five years to address the need for greater access to healthy foods in underserved communities across the country, building on its successful 12-store pilot in Chicago.
- The Company exceeded its “Rewiring for Growth” cost reduction goal of $1 billion in annual savings, concluding its three-year restructuring and cost-saving initiative launched in 2008.
- Walgreens was named to *Fortune* magazine’s World’s Most Admired Companies list for the 18th consecutive year, and was ranked 32nd on the *Fortune 500* list of the largest U.S.-based companies.

Financial Highlights

For the years ended August 31, 2011 and 2010 (In millions, except per share amounts)

	2011	2010	Increase
Net Sales	**$72,184**	$67,420	7.1%
Net Earnings *(1)*	**$ 2,714**	$ 2,091	29.8%
Net Earnings per Common Share (diluted) *(1)*	**$ 2.94**	$ 2.12	38.7%
Shareholders' Equity	**$14,847**	$14,400	3.1%
Return on Average Shareholders' Equity	**18.6%**	14.5%	
Closing Stock Price per Common Share	**$ 35.21**	$ 26.88	
Total Market Value of Common Stock	**$31,312**	$25,230	
Dividends Declared per Common Share	**$ .7500**	$ .5875	
Average Shares Outstanding (diluted)	**924**	988	

(1) Fiscal year 2011 amounts include a $273 million, or $0.30 per diluted share, after-tax gain on the sale of Walgreens Health Initiatives, Inc.

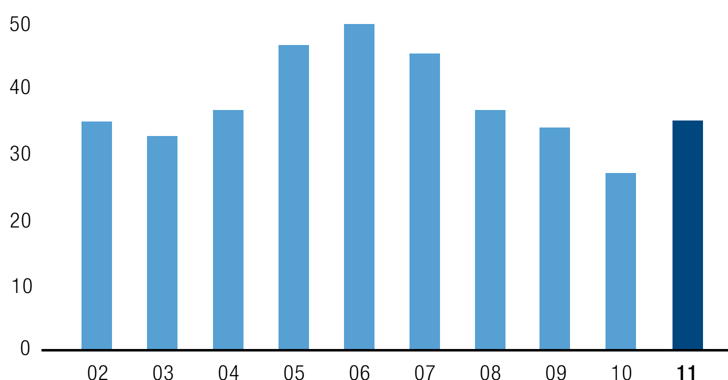
Company Highlights

		2011	2010	2009	2008	2007
Locations	Openings					
	New Locations	**261**	388	602	608	501
	Acquisitions	**36**	282	89	423	120
	Closings	**133**	120	129	94	85
	Net Openings	**164**	550	562	937	536
	Locations *(1)*	**8,210**	8,046	7,496	6,934	5,997
	Sales Area *(2)*	**85,619**	83,719	78,782	72,585	66,386
Product Class Sales	Prescription Drugs	**65%**	65%	65%	65%	65%
	Non-prescription Drugs *(3)*	**10%**	10%	10%	10%	10%
	General Merchandise *(3)*	**25%**	25%	25%	25%	25%

(1) Includes drugstores, worksite health and wellness centers, infusion and respiratory services facilities, specialty pharmacies and mail service facilities.
(2) In thousands of square feet.
(3) Based on store scanning information.

Walgreens Fiscal Year Stock Performance

Fiscal year-end closing price per share in dollars



Letter to Shareholders

Gregory D. Wasson *(left)*
President and Chief Executive Officer

Alan G. McNally
Chairman of the Board

Fiscal 2011 was a year of strong performance for Walgreens. We achieved our 37th consecutive year of record sales despite a challenging economy. Our focus on delivering exceptional value and service, fueled by our culture of operational excellence and innovation, produced record profits, our strongest increase in net income in a decade and our largest growth in earnings per share in more than 15 years.

We made substantial progress in the transformation of the Company, putting Walgreens in a strong position for future success by executing – and advancing – our bold strategy for near- and long-term growth.

Three years ago, we launched our "Plan to Win" – one of the most important strategic and operational transformations in our 110-year history. The plan focused on leveraging our "center of gravity" – the best store network in America; enhancing the customer experience; and achieving major cost reduction and productivity gain. Our goals were to become America's most trusted and convenient provider of consumer goods and services and pharmacy, health and wellness solutions, and to return the Company to strong double-digit growth in earnings per share, increasing return on invested capital and top-tier shareholder return just as soon as we possibly could.

In fiscal 2011, as we completed key initiatives and progressed in our Plan to Win, we also seized the opportunity to crystallize and advance our vision and strategies, and set our sights even higher – to become "My Walgreens" for everyone in America, the first choice for health and daily living across the nation, and a central part of people's lives and the communities where they live and work.

Our vision of My Walgreens is more than a drugstore – we are becoming a retail health and daily living destination, providing convenient, multi-channel access to goods and services with best-in-class customer experience. Our pharmacies – on the front lines of health care in America – serve as a centerpiece in improving patients' overall health, and improving access to care and lowering costs through an expanded scope of community-based health and wellness solutions.

The core, fundamental strengths of our Company, developed over more than a century – the best, most convenient store network in America, our trusted and iconic brand, and our strong balance sheet and financial flexibility – serve as the bedrock of our ongoing transformation.

Strong performance through innovation and operating excellence

As we advanced our strategic vision, the Company recorded strong results across a broad spectrum of measures in fiscal 2011.

Disciplined focus on our core business strategy helped set new records in fiscal 2011 – sales of $72.2 billion, gross profit of $20.5 billion and earnings per diluted share of $2.94, which included a $0.30 per diluted share after-tax gain on the sale of our pharmacy benefit management business. In addition, our cash flow from operations was $3.6 billion. All of these contributed to a dividend increase of 28.6 percent in July and cash returned to shareholders through dividends and share repurchases of $2.4 billion in fiscal 2011. Our capital allocation strategy was reflected in the purchase of drugstore.com and our decision to sell our pharmacy benefit management business.

Our Company continued to achieve important milestones in our transformation strategy, building on our historic strengths and sharpening our focus on our core business to deliver even better performance in our more than 7,700 stores:

- As we integrated the Duane Reade drugstore chain in New York City, we began building many of its unique "urban retailing" and store design concepts into Walgreens stores across the country. In turn, we powered Duane Reade's pharmacy operations with the best of Walgreens systems and expertise.
- We have converted more than 5,000 stores and opened more than 500 new stores with our "Customer Centric Retailing" (CCR) initiative launched in 2009. With this program, which enhances the store's "look and feel" and the shopper's experience, we have reported higher customer satisfaction and increased sales. Openings and conversions to the new format reached a peak of 140 stores per week, totaling more than 3,700 stores last year alone.
- We greatly expanded our answer to "food deserts" – underserved communities lacking ready access to fresh, healthy foods – with a plan to offer convenient access to an expanded selection of fruits, vegetables and other staples at 1,000 Walgreens stores across the country, building on our successful 12-store pilot in Chicago.

• As we refresh our stores, we continue to broaden the range of health and daily living products we offer. In fiscal 2011, we expanded our highly successful Walgreens private brand selections for the value-minded consumer with the launch of a new brand name, "Nice!". With Nice! and Duane Reade's "Good & Delish," we now offer more than 400 high-quality grocery and household private-brand products. Beer and wine selections – including Walgreens Big Flats 1901 – have now been added to nearly 5,300 stores.

• In pharmacy, we continue to make great progress on our initiative to advance community pharmacy – enhancing the patient's experience, expanding our scope of services, and improving productivity to lower cost. Patients are beginning to see something new at Walgreens; in our new pilot store design, we are bringing our pharmacists out into the store to promote more face-to-face conversations and personal interactions with patients.

• Through our pharmacies and health centers, we advanced our leadership in providing flu shots and other immunizations, delivering 6.4 million flu shots last year as we continued to serve as the number-one provider of flu shots other than the federal government. Teaming with the U.S. Department of Health and Human Services, Walgreens donated more than $10 million worth of flu shots to uninsured and underserved families.

• Building on our core business, we advanced our multi-channel strategy with the acquisition of a leading e-commerce site, drugstore.com. We gained not only the drugstore.com and Beauty.com websites and their customer service and distribution centers, but also access to more than 3 million online customers and 60,000 drug, health, beauty and skincare products – expanding our already strong online offering. As well, we introduced our new "Web Pickup" services at many Chicago-area and San Jose, California, locations, enabling customers to shop online and pick up their orders at a store in as little as an hour.

• Today, no retailer in America is better positioned than Walgreens to bring "bricks and clicks" together, combining our thousands of convenient locations in communities across the country with the convenience of outstanding online access.

• As we continue to focus on – and invest in – our core business, we completed the sale of our pharmacy benefit management business to Catalyst Health Solutions, Inc., for $525 million, subject to certain adjustments.

• Importantly, we continue to take steps to control costs and increase productivity. We achieved our three-year goal to deliver $1 billion in annual pre-tax savings through our "Rewiring for Growth" initiative, and advanced this strategy by launching "Fuel Well" – building continuous improvement and innovative cost-reduction and productivity gain into our daily business operations.

The evolving consumer and health care system

Through our ongoing transformation, Walgreens is ready to meet the evolving needs of consumers and patients in today's challenging economy and changing health care system.

Three years after the "Great Recession" began, research shows that value-minded consumers are seeking more than good quality at low prices – they also want connection and community, kindness and empathy, and a positive shopping experience.

Patients are seeking value, quality and personal service as the health care system continues to change through both legislation and market dynamics. The Patient Protection and Affordable Care Act of 2010 is expected to bring 32 million more Americans into the health care system in 2014, and the aging population faces a higher incidence of chronic and complex conditions. Patients and payers are seeking new solutions to address the growing need to provide convenient access to quality health care and, at the same time, rein in skyrocketing health care costs.

Pharmacy is a key part of the solution – and a leading provider of accessible, affordable health care in communities across the nation.

Our pharmacies help reduce costs by driving greater penetration of generic drugs – roughly 74 percent last year – resulting in significant savings on each prescription. For chronic conditions, we also promote 90-day refills at our retail pharmacies, which provide on average 6 to 8 percent savings compared with three 30-day prescriptions.

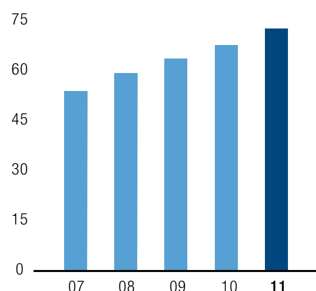
Walgreens also provides a broad range of health care and clinical services as extensions of our traditional pharmacy services:

• Our more than 350 in-store Take Care health clinics across the nation, with a plan to expand this number over the next few years, offer a wide range of convenient, affordable health care services as an alternative to costlier primary care physicians and emergency room care.

• In addition to our extensive immunizations program, Walgreens pharmacies provide medication adherence services, counseling and other assistance that help lower medical costs by improving outcomes. Our range of health testing services, including blood glucose, A1C hemoglobin levels and free blood pressure tests, also serve to help lower costs through prevention.

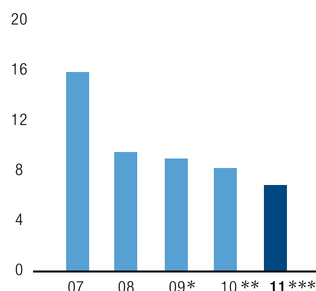
Sales

In billions of dollars



Expenses

Selling, General and Administrative expense growth in percent



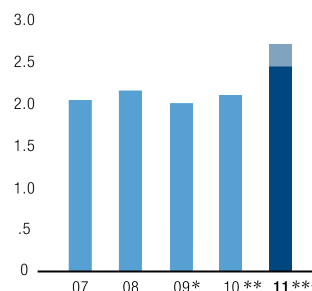
** Fiscal 2009 includes 1.2 percent attributable to restructuring costs.*

*** Fiscal 2010 includes 1.5 percent attributable to restructuring costs and Duane Reade costs.*

**** Fiscal 2011 includes 2.1 percent attributable to restructuring costs, Duane Reade costs and drugstore.com costs.*

Earnings

In billions of dollars



** Fiscal 2009 includes after-tax restructuring costs of $160 million.*

*** Fiscal 2010 includes after-tax restructuring costs of $67 million, after-tax Duane Reade costs of $56 million, and $43 million of taxes related to the elimination of the Medicare Part D tax benefit for retirees.*

**** Fiscal 2011 includes after-tax restructuring costs of $28 million, after-tax Duane Reade costs of $7 million and $18 million of after-tax drugstore.com costs. The shaded portion represents an after-tax gain on the sale of our pharmacy benefit management business of $273 million.*

• Walgreens is the nation's leading provider of home infusion and a major provider of specialty pharmacy services, providing cost-effective solutions for patients who need infused medication, including chemotherapy, respiratory services and oxygen at home or in other ambulatory settings.

• As well, Walgreens is the nation's leading operator of hospital outpatient pharmacies, serving 137 health systems nationwide. We are also the largest and most comprehensive manager of worksite health and wellness centers on employer campuses, with more than 350 locations across the country.

As we expand affordable health care choices, we also seek fair, acceptable and predictable reimbursements for the value we provide. Last year, Walgreens sought to renew our contract with pharmacy benefit manager Express Scripts to continue serving its network in 2012 and beyond. We offered a number of cost-saving proposals, including controlling prescription reimbursements. However, negotiations have been unsuccessful as Express Scripts set forth terms, including reimbursement rates that were below the industry average cost to provide a prescription, that were not in the best interests of our Company, our customers, our employees or our shareholders. Walgreens began informing health plans and patients that we plan not to be part of the Express Scripts network after December 31, 2011, when our contract with Express Scripts expires. We are moving forward with relationships for partners that value the choice, cost-effectiveness, convenience and service we provide and want to ensure their patients continue to have access to Walgreens.

My Walgreens for everyone in America

When we hear consumers using the phrase "My Walgreens," we are delighted to be part of their lives and their communities, and to know they have a deep personal connection with our people and our stores. Becoming My Walgreens in every community across America is a lofty goal. But with our expansive network of stores, expanding health care services and commitment to creating a satisfying customer experience, we can own the strategic territory of "well" – where health and happiness come together – in every community we serve.

With this aspiration, last year we took a fresh look at our Plan to Win in light of our progress, the initiatives we completed, and the new strategic challenges and opportunities before us. We refined, sharpened and crystallized our vision into five strategies, and took important steps to execute each strategy.

Transform our traditional drugstore to a retail health and daily living destination
As we complete the refresh of our stores, Walgreens is also moving forward to completely redefine – even revolutionize – the drugstore experience, setting us apart in our industry, and establishing My Walgreens as a destination for consumers to satisfy a broad range of health and daily living needs.

We are bringing together all our transformational strategies developed over the past three years to pilot exciting new concept stores for Walgreens, combining enhancements in our pharmacies and health clinics, our improved CCR merchandising, our learning from Duane Reade, and new e-commerce techniques and technologies from our multi-channel strategy.

Through calendar year-end 2011, we will have converted or opened 20 of these new concept stores in the Chicago area, as well as our 22,000 square-foot "flagship" Duane Reade store at 40 Wall Street in New York City, and we have begun expanding the pilot to Indianapolis, Indiana. Customers, employees and community leaders visiting these stores have reacted with delight. In turn, we are applying what we learn from these new concept stores to enhance Walgreens health and daily living offerings in our stores across the country.

Advance community pharmacy
Building on our industry leadership in pharmacy-based health services, we plan to expand our reach beyond traditional community pharmacy, coordinate and integrate with national, regional and local health systems, and play an expanded role in delivering affordable health care.

With regard to health systems and physician groups, we are moving quickly to establish closer relationships with premier partners in markets nationwide. Last year, we joined with Northwestern Memorial Physicians Group of Chicago to undertake a new coordinated health care program to improve patient outcomes. In addition, our Take Care Clinics joined with Memorial Health of Jacksonville, Florida, and with Ochsner Health Systems of New Orleans to increase opportunities for clinical collaboration and improve patient access to high-quality, convenient, affordable health care options.

We entered into an agreement with Johns Hopkins Medicine to promote collaboration on population-based research and to jointly review and develop protocols to improve outcomes for patients with chronic diseases. Together, we will explore the development of new models for improving care for individuals. This will include the creation of new educational and training programs for Walgreens 75,000 health care service providers.

Expanding our preventive health care services, Walgreens last year added testing for total cholesterol and HDL (high-density lipoprotein), blood glucose and A1C at more than 1,600 pharmacies in 33 states. Each test includes a free blood pressure reading and personal consultation with a Walgreens pharmacist.

In fiscal 2011, we began working with the National Foundation for Infectious Diseases to educate the public and health care professionals regarding flu prevention resources, and joined with Families Fighting Flu, a non-profit organization that comprises families and health care practitioners, to heighten flu awareness and encourage vaccinations for children and families.

Illustrating our expanding role in health care, the Care Continuum Alliance recently welcomed Walgreens among its newest members, noting our "work to promote healthful lifestyles and empower consumers to reduce risk aligns with [the Alliance's] mission to improve care quality and value, particularly for people with or at risk of chronic disease." Our participation will help Walgreens learn more from other members regarding strategies to improve health care outcomes and reduce avoidable care costs for our customers and patients.

Outstanding customer experience through enhanced employee engagement
Becoming My Walgreens for everyone in America means providing the consumer more than the products and services, choice, convenience, savings and multi-channel access that they demand. We must also offer an experience that gives the consumer a sense of delight and connection with Walgreens and our people.

For most of our history, Walgreens core strength has been our convenient locations on the best corners in America. Today, we are building on the strength of our locations to make each Walgreens a place that consumers prefer because we provide an outstanding – even memorable – shopping experience.

That starts with our people, who work hard every day to provide best-in-class customer service. Our customer and patient satisfaction continues to improve as we work to create a sustainable competitive advantage by delivering memorable customer interactions. To this end, we began our "Well Cared For" initiative to strengthen employee engagement by setting new standards, providing training and developing leadership skills. As well, in 2012 Walgreens plans to introduce a nationwide customer-loyalty program truly differentiated from our competitors.

Last May, the courageous, caring response by Walgreens team members to the devastating tornados that tore through Joplin, Missouri, illustrated their incredible spirit of customer and community service. Of our three stores in Joplin, one was destroyed, one sustained broken windows and roof damage, and the third, which was not affected, we converted to a 24-hour location. A Red Cross triage unit to help residents was set up under the canopy of our damaged building, and employees used store stock to provide the Red Cross nurses with needed resources, such as antiseptic, glucose machines, test strips, blood pressure machines, crutches, batteries and flashlights. This location became one of the hub triage centers in the city.

Well
at Walgreens

The Company is piloting a new store experience that moves beyond the traditional drugstore format to a health and daily living destination. At the core is the health center *(shown here)* that includes a redesigned pharmacy and, at some locations, a Take Care Clinic. In this area, patients are greeted by a health guide *(center)* who directs them to the services they need. The new format is being piloted at this store in Oak Park, Illinois, and other stores in Illinois and Indiana.

As team members across the country embrace the spirit that Walgreens employees demonstrated in Joplin, outstanding and caring customer experience becomes synonymous with the Walgreens brand. My Walgreens for everyone in America means establishing an emotional connection for our patients and customers with our people, our stores, our brand, who we are as a Company, and the role we play in communities as a cornerstone of health and daily living.

New channels and markets

Walgreens continues to invest heavily in e-commerce and mobile technology to leverage our brick-and-mortar locations with convenient, sophisticated online options. Through our expanding multi-channel strategy, customers will be able to access "what they want" – a broader selection of products; "where they want it" – whether delivered to their homes or available for pickup at the store; and "when they want it" – two days, next day or next hour.

Multi-channel shoppers are estimated to be three times more valuable than a single-channel shopper. And, when they choose to shop at the store, they want a great experience. So we continue to invest in our bricks and expand our choice of clicks to provide our shoppers the best of both worlds.

In fiscal 2011, as we put new smartphone enhancements in the hands of Walgreens customers nationwide, the response has been phenomenal. Walgreens newest mobile phone application, which includes "Refill by Scan," continues to grow in popularity, with nearly 3 million downloads last year. By broadening our social media presence, surpassing 1 million Facebook fans and integrating our store network last year through Facebook Places and Foursquare, we continue to strengthen our personal connection with consumers.

Reinvent our cost structure

A key element of our transformational strategy is cost reduction and productivity gain, and our Rewiring for Growth initiative launched in 2008 delivered more than $1 billion in annual pre-tax cost savings. Completing this initiative, we are now advancing this strategy by embedding continuous process improvement and innovation into our corporate DNA, constantly looking for new ideas to improve processes and reduce cost structures.

Summary

Walgreens strong performance and substantial progress in fiscal 2011 puts the Company in an excellent position to execute the next phase in our transformation, play a bigger role in people's lives and in their communities, and create more value for consumers, patients, payers and Walgreen shareholders. Our sharp focus and relentless commitment to executing with discipline are now "wired" into our daily work across the Company.

In fiscal 2012, we will continue our sharp focus on revenue growth, cost savings and capital allocation, and enhancing the relevance of our products and services to customers, patients, payers and the communities we serve. In doing so, we remain committed to our long-term goal of achieving double-digit growth in earnings per share, increasing return on invested capital and top-tier shareholder return.

The Company continues to benefit from our outstanding senior leadership team that blends a broad range of internal and external experience and expertise, and the strength and dedication of our Board of Directors. Last year, we announced the appointment of Joseph Magnacca, from Duane Reade, as our new president of Daily Living Products and Solutions; Thomas J. Sabatino, Jr., as executive vice president, general counsel and corporate secretary, succeeding Dana Green, who retired after 37 years of outstanding leadership and service with the Company; Jeffrey Berkowitz as senior vice president of pharmaceutical development and market access; and Graham W. Atkinson as senior vice president and chief customer experience officer.

Walgreens continued strong performance and progress is a tribute to our superb team of 247,000 employees and their dedicated service to our customers and our Company. We greatly appreciate and applaud their hard work, commitment and support as we seize new opportunities. We most sincerely thank and appreciate our customers, patients and payers, our suppliers and communities across America for making Walgreens an important part of their lives. And we offer our deepest gratitude to our shareholders for your trust and confidence in our Company, making possible our vision of My Walgreens for everyone in America.

Sincerely,

Alan G. McNally
Chairman of the Board

Gregory D. Wasson
President and Chief Executive Officer

November 16, 2011

Every day | Providing integrated care

Walgreens is expanding its pharmacy, health and wellness services to enhance the well-being of patients, whether they are at home, at work or in the hospital.

Walgreens first met Delilah Valdez and her family in the hospital at the University of Miami/Jackson Memorial Hospital, where she underwent multiple organ transplant surgery to treat a rare gastrointestinal disorder. With the care of Walgreens Specialty on-site pharmacists, pharmacists at home in Texas and a whole team of medical professionals, Delilah today is thriving beyond her doctors' expectations.

The integrated care the Valdez family depends on is just one extraordinary example of the high-quality health solutions Walgreens provides every day at its on-site pharmacies in hospitals and medical centers, Take Care Clinics and employer worksite health and wellness centers. These locations, staffed by physicians, physician assistants, nurse practitioners, registered nurses, pharmacists, pharmacy technicians, health coaches, dietitians and fitness instructors, are touching tens of thousands of lives every day. As a result, the Company is lowering costs for payers and patients and enhancing health outcomes.

In many cases, the first contact the Company has with patients is in the hospital, through people like Felisha Hinds, the on-site Walgreens pharmacy manager who was part of the team that cared for Delilah. The Company operates 137 pharmacies on the campuses of medical centers and hospital systems nationwide. Pharmacists at these locations work with the hospital care delivery teams to provide the right medication therapies and answer patients' questions about the medications before they are discharged.

Once patients are home from the hospital, Walgreens specialty pharmacy services provide ongoing support. Using these services, patients can choose to get their specialty medications either at their retail Walgreens pharmacy or through the Company's central specialty facilities. They also have access to highly trained specialists who can assist in navigating the unique issues that come with these complex disease states. When Delilah's family finally returned home, pharmacy manager Tunisha Che took over seamlessly from Hinds to ensure her care continued uninterrupted, helping the Valdez family continue on their journey to a more healthy life.

Felisha Hinds *(center)*, on-site pharmacy manager at Walgreens Transplant Specialty Pharmacy in Miami, consults with Dr. Andreas Tzakis *(right)*, one of the surgeons on the team that performed a seven-organ transplant on 18-month-old Delilah Valdez at the University of Miami/Jackson Memorial Hospital. Hinds also worked with the Valdez family while Delilah was still in the hospital to make sure they understood the complex medication therapy the baby would require after she was released from the hospital.

After her daughter underwent transplant surgery in Miami and was discharged, Julissa Cerda *(right)* and her family returned home to San Antonio, Texas, where they again relied on Walgreens for Delilah's medications. Tunisha Che *(left)*, pharmacy manager in San Antonio, continued the care begun in Miami. This soft transfer from hospital to local Walgreens demonstrates how the Company's pharmacists are getting closer to the patient and driving value through coordinated care.

Born with a rare gastrointestinal disorder that compressed her entire digestive tract, Delilah Valdez required multiple transplants. Now, several months after the surgery, "Delilah is doing awesome," says her father, Agapito Valdez *(above)*. Delilah is more than surviving – she's thriving beyond her doctors' expectations. And Walgreen pharmacists are part of the health care team that is monitoring her progress as she grows stronger and leads a more normal life.

Every day | Caring for patients

Walgreen patient Allen Hoopingarner chose to retire in Burr Oak, Michigan, a rural community where he and his wife, Sandy, live with their horses. The Hoopingarners represent the growing number of people 65 years of age or older who live an active lifestyle with help from their Walgreen pharmacist.

Sandy Hoopingarner *(right)* has her blood pressure tested regularly by pharmacy manager Jane Warner *(left)* and her staff in Sturgis, Michigan, near Sandy's home in Burr Oak. Patients like the Hoopingarners take advantage of the Company's broader scope of health services, which include immunizations, chronic disease management and health screenings.

Walgreens is advancing community pharmacy by placing the emphasis on the critical relationship between pharmacist and patient.

Allen and Sandy Hoopingarner live in a small town in Michigan with their five horses, and they depend on Walgreens and their family physician of 40 years to help them stay active and vital. "To enjoy our retirement as long as possible, we pick up prescriptions and get our blood pressure checked at Walgreens," Allen says.

The Hoopingarners represent a growing number of Americans who are turning 65, living longer and managing chronic conditions. With one in three citizens 65 years or older by 2021, and about 32 million more gaining medical coverage due to health care reform, the health care system will be increasingly challenged to provide quality care.

For Walgreens, these challenges create opportunities to provide meaningful care to people like the Hoopingarners with thoughtful services, more interaction with pharmacists and more collaboration with physicians and other health care providers. Filling these needs is fueling Walgreens transformation from a traditional drugstore to a retail health and daily living destination.

The essence of the transformation is ensuring pharmacists have more time to consult with patients. To find time, Walgreens has improved efficiency with better technology and improved processes. This allows the Company to add new services, which started with flu shots and now includes immunizations, chronic disease management, health screenings and adherence programs. For patients like the Hoopingarners, that means more time with their local pharmacist, Jane Warner; more advice on how to manage their conditions; and the opportunity for Warner to work closely with their physician, Dr. Yazdi Amaria – all with the goal of improving their health and keeping down their overall cost of care.

With this new approach to community pharmacy, the Company is filling the gaps in care that are a simple reality in today's health care system.

Allen and Sandy Hoopingarner, both being treated for high blood pressure, meet with Dr. Yazdi Amaria *(center)*, who has been their family physician for about 40 years. Dr. Amaria and the Walgreens pharmacy staff in Sturgis, Michigan, collaborate as a health care team to give patients in this small town quality care that improves health outcomes for people with chronic conditions including diabetes and heart disease.

Every day | Helping people live well

This year, Walgreens realigned its private brand strategy to use the "Walgreens" brand exclusively for health and wellness products. To connect the brand to the Company's "cause marketing" programs, 1 cent of every purchase of a Walgreens brand health and wellness product, like the vitamins for women shown here, goes to support preventive wellness services in local communities through the Walgreens "Way to Well" Fund. For more information, visit Walgreens.com/WaytoWell.

Walgreens actively supports healthy choices, as the Company works to become America's first choice for health and daily living.

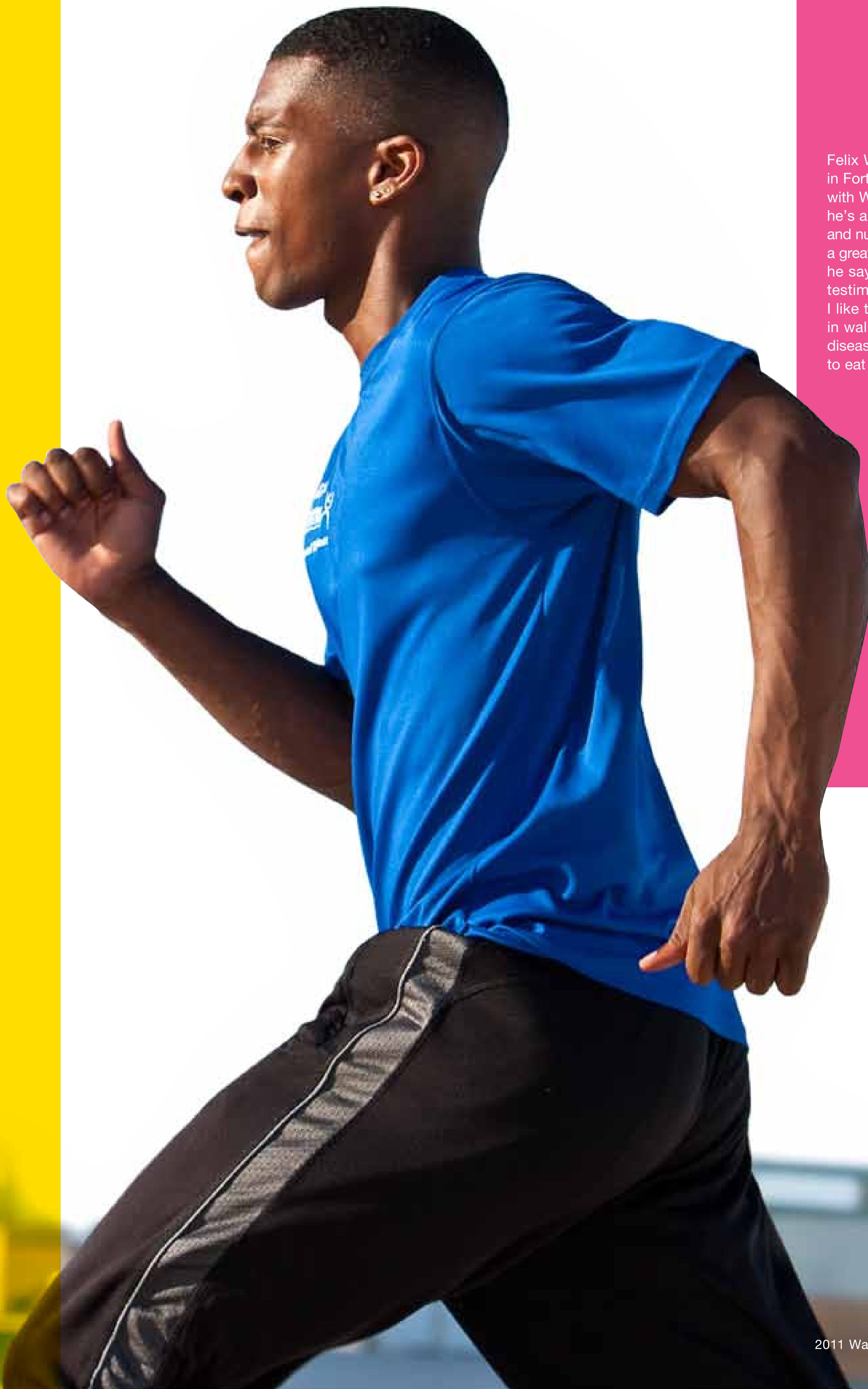
Felix Williams, a personal trainer in Fort Lauderdale, Florida, appreciates that Walgreens commitment to helping people live well is more than a slogan. He joined the Company's "Walk with Walgreens" campaign to reinforce his own personal commitment to fitness and nutrition.

The Walk with Walgreens program is dedicated to getting America moving and educating consumers about the prevention and early detection of major conditions like cancer, diabetes and heart disease. Through the program, consumers register online at Walgreens.com/walk, log their daily number of steps and receive rewards and coupons. In fiscal 2011, nearly 250,000 people signed up, and walkers logged more than 3 billion steps, joining Felix in his commitment to good health and fitness.

The Walk is a cornerstone of the Company's "Way to Well" Commitment, a four-year, $100 million health initiative to bring preventive health care resources, health testing services and charitable programs to Walgreens stores nationwide. To make the Company's commitment even more robust, Walgreens has linked the program to its popular Walgreens branded products.

In fiscal 2011, the Company realigned its "Walgreens" brand exclusively for health and wellness products, such as Wal-Phed and Wal-Zyr. In terms of revenue, this brand is the Company's best-seller. With the realignment, every time a customer buys a Walgreens brand product, 1 cent is donated to the Walgreens Way to Well Fund, up to $3 million annually. This fund provides free preventive health tests and other health and wellness services to customers in local communities. In this way, it helped Walgreens provide more than 250,000 tests in fiscal 2011, making a significant contribution to health and wellness nationwide.

About 8,000 walkers throughout Florida helped kick off the "Walk with Walgreens" campaign for customers in April. This was one of several Walk events coordinated by Walgreen community leaders across the country. Walk with Walgreens is dedicated to getting people moving and educating them about the prevention and early detection of major conditions like cancer, diabetes and heart disease.



Felix Williams, a personal trainer in Fort Lauderdale, joined the Walk with Walgreens campaign because he's a strong proponent of exercise and nutrition. "Walk with Walgreens is a great way to get people motivated," he says. "I've read a lot of the testimonials on the website and I like the way the Company ties in walking as a way to prevent diseases and motivates people to eat right and keep moving."

Every day | Enhancing daily living

Walgreens efforts to enhance the customer experience are gaining momentum as the Company pilots new store formats and expands its offerings with fresh food, upscale beauty and new brands.

Over the next five years, Walgreens plans to convert or open at least 1,000 “food oasis” stores, similar to this one in Chicago, to address the need for greater access to healthy foods in underserved communities across the country.

Raymond and Cassandra Huang balance busy lives, running a coffee shop in Redwood City, California, that offers fresh, homemade salads and sandwiches. Raymond also holds down a second job to make ends meet. For them, Walgreens combination of convenience, new fresh food offerings and essential health needs fits the bill.

To continue to meet their needs, Walgreens is making its stores more relevant to consumers and easier to shop. The first step was a cost-effective refresh of the front end, which gave stores a cleaner look and better managed assortment. The goals were to enhance customer experience, boost comparable store sales, reduce inventory and increase efficiency – all of which have been accomplished.

With the refresh completed, Walgreens is building on its vision to become “My Walgreens” for everyone in America – the first choice for health and daily living. To differentiate itself from other chains, the Company is piloting a new store experience to help customers live well. Pilot stores feature an entirely redesigned interior with fresh food, redesigned beauty and a lighter, brighter design. The core of the store is the health center that includes a redesigned pharmacy, and at some locations, a Take Care Clinic. As patients enter this area, they are greeted by a “health guide” who directs them to the services they need and provides the information they seek. This new model is being piloted in certain stores in Illinois and Indiana.

In existing stores, the Company is enhancing its health and daily living offerings by revitalizing and strengthening its private brand program, introducing upscale beauty “Look Boutiques” in some stores and expanding its fresh food concept in urban areas to provide more options in underserved communities.

Besides running a coffee shop in Redwood City, California, Raymond Huang is an accountant in San Francisco. To stay healthy while holding two jobs, Raymond eats well, exercises and watches his blood pressure. Walgreens supports his health and daily living needs by selling healthy foods, over-the-counter medications and medical devices like this heart monitor for home use.

Customers Raymond and Cassandra Huang run a coffee shop in Redwood City, California, where they also serve salads and other healthy items. All the healthy ingredients for this meal came from a Walgreens store in San Francisco. “It’s nice to know that in an emergency we can stop at Walgreens for the items we need,” says Cassandra. Walgreens recently introduced its new fresh food format to several stores in San Francisco.

Every day | Getting closer to customers

Alana Bowman in Brandon, Mississippi, is very particular about the quality of skincare and makeup products she buys because she has sensitive skin. "I'm glad that Beauty.com and Walgreens.com carry a good selection of hypoallergenic and natural products," she says.

A self-proclaimed “online shopping expert,” Alana Bowman in Brandon, Mississippi, carefully evaluates the best websites for items she uses regularly, such as makeup, shampoo and skincare products. Walgreens.com and Beauty.com, recently acquired by Walgreens, are two of her favorite sources. “I like to order online to avoid impulse shopping,” she says. “I’m always looking for special deals, coupons and free shipping offers. I’m impressed with what I find on the Walgreen sites.”

Walgreens is developing more points of care so customers have the convenience, choice and control to easily reach the Company through multiple channels.

A busy mother with a full-time career, Alana Bowman in Brandon, Mississippi, shops Walgreens and drugstore.com websites, looking for the specific beauty products she needs and the deals she wants. “As a single mom with a full-time job, I don’t have much spare time to seek out these items in stores,” she says. “Walgreens websites make it so much easier.”

To serve customers like Alana, Walgreens is working to become the leading multi-channel retailer, with the goal to help people find what they want, where they want it and when they want it. Studies show that a multi-channel shopper is three times more valuable than a single-channel shopper, which is why Walgreens is aggressively focused on expanding its e-commerce presence.

The Company’s multi-channel network starts with its more than 7,700 stores at prime locations convenient to about 75 percent of U.S. consumers who live within five miles of a Walgreens store. Linked to and supporting the stores is the Company’s website, Walgreens.com, which puts customers within a click of reaching Walgreens anywhere in the country, 24 hours a day. Half of the site visitors say their next action is to visit a Walgreens store. Using the combination of Walgreens.com and Walgreens stores, customers can order online and pick up their orders in as little as an hour at about 500 stores in four states.

Walgreens uses mobile phone applications as another channel, allowing customers to refill prescriptions, order photos, browse the weekly ads and more. With smartphones comprising the majority of new mobile phones sold in 2011, consumers can access Walgreens in the palm of their hand. They can also access Walgreens through the Company’s on-site pharmacies in hospitals, worksite clinics, call centers, and social media sites, such as Facebook and Twitter.

This year, Walgreens expanded its online reach with the acquisition of drugstore.com, based in Bellevue, Washington. By adding drugstore.com and its sister sites, including Beauty.com and VisionDirect.com, the Company has gained more than 3 million online customers and can provide easier access to a wide selection of products and services.

Angelina Lombardo, photo specialist in Wheeling, Illinois, provides curbside delivery to a customer using Walgreens Web Pickup service. This new service, being tested in about 500 stores in California, Illinois, Indiana and Wisconsin, is a convenient way customers can place day-to-day shopping orders online to be picked up at a nearby store, in as little as an hour. It’s another way Walgreens is bringing convenience, choice and control to on-the-go shoppers.

Board of Directors *As of November 16, 2011*

(Back row – left to right)

William C. Foote
Chairman of the Board –
USG Corporation
Elected 1997 *(2) (4*)*

Nancy M. Schlichting
President and
Chief Executive Officer –
Henry Ford Health System
Elected 2006 *(1) (2)*

Alejandro Silva
Chairman of the Board and
Chief Executive Officer –
Evans Food Group, Inc.
Elected 2008 *(1) (4)*

Steven A. Davis
Chairman of the Board and
Chief Executive Officer –
Bob Evans Farms, Inc.
Elected 2009 *(3) (4)*

Mark P. Frissora
Chairman of the Board and
Chief Executive Officer –
Hertz Global Holdings, Inc.
and The Hertz Corporation
Elected 2009 *(3*) (4)*

Alan G. McNally
Chairman of the Board –
Walgreen Co.
Special Advisor –
BMO Financial Corporation
Elected 1999

(Front row – left to right)

David Y. Schwartz
Former Partner –
Arthur Andersen LLP
Elected 2000 *(1*) (3)*

David J. Brailer, MD, PhD
Chairman –
Health Evolution Partners
Elected 2010 *(1) (3)*

Gregory D. Wasson
President and
Chief Executive Officer –
Walgreen Co.
Elected 2009

James A. Skinner
Vice Chairman and
Chief Executive Officer –
McDonald's Corporation
Elected 2005 *(1) (2*)*

Ginger L. Graham
President and
Chief Executive Officer –
Two Trees Consulting, Inc.
Elected 2010 *(2) (3)*

(1) Audit Committee
(2) Compensation Committee
(3) Finance Committee
(4) Nominating and Governance Committee
** Committee Chair*

Officers *As of November 16, 2011*

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Gregory D. Wasson
President and
Chief Executive Officer

Sona Chawla
President,
E-Commerce

Kermit R. Crawford
President,
Pharmacy, Health and Wellness Services and Solutions

Joseph C. Magnacca
President,
Daily Living Products and Solutions

Mark A. Wagner
President, Community Management

Wade D. Miquelon
Executive Vice President and
Chief Financial Officer

Thomas J. Sabatino, Jr.
Executive Vice President,
General Counsel and
Corporate Secretary

Graham W. Atkinson
Senior Vice President and
Chief Customer Experience Officer

Mia M. Scholz
Senior Vice President,
Controller and
Chief Accounting Officer

Timothy J. Theriault
Senior Vice President and
Chief Information Officer

Kathleen Wilson-Thompson
Senior Vice President and
Chief Human Resources Officer

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Senior Vice President and
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Jeffrey L. Kang, MD, MPH

J. Randolph Lewis

Kevin R. Walgreen

Treasurer

Jason M. Dubinsky

Vice Presidents

Thomas J. Connolly

Michael Ellis

Charles V. Greener

John W. Spina

Colin F. Watts

Denise K. Wong

General Auditor

Christopher Domzalski

Five-Year Summary of Selected Consolidated Financial Data

Walgreen Co. and Subsidiaries (Dollars in millions, except per share and location amounts)

Fiscal Year		**2011**	2010 *(1)*	2009	2008	2007
Net Sales		**$72,184**	$67,420	$63,335	$59,034	$53,762
	Cost of sales *(2)*	**51,692**	48,444	45,722	42,391	38,518
	Gross Profit	**20,492**	18,976	17,613	16,643	15,244
	Selling, general and administrative expenses *(2) (3)*	**16,561**	15,518	14,366	13,202	12,093
	Gain on sale of business *(4)*	**434**	—	—	—	—
	Operating Income	**4,365**	3,458	3,247	3,441	3,151
	Other (expense) income	**(71)**	(85)	(83)	(11)	38
	Earnings Before Income Tax Provision	**4,294**	3,373	3,164	3,430	3,189
	Income tax provision *(5)*	**1,580**	1,282	1,158	1,273	1,148
	Net Earnings	**$ 2,714**	$ 2,091	$ 2,006	$ 2,157	$ 2,041
Per Common Share	Net earnings					
	Basic	**$ 2.97**	$ 2.13	$ 2.03	$ 2.18	$ 2.04
	Diluted	**2.94**	2.12	2.02	2.17	2.03
	Dividends declared	**.75**	.59	.48	.40	.33
	Book value	**16.69**	15.34	14.54	13.01	11.20
Non-Current Liabilities	Long-term debt	**$ 2,396**	$ 2,389	$ 2,336	$ 1,337	$ 22
	Deferred income taxes	**343**	318	265	150	158
	Other non-current liabilities	**1,785**	1,735	1,396	1,410	1,285
Assets and Equity	Total Assets	**$27,454**	$26,275	$25,142	$22,410	$19,314
	Shareholders' Equity	**14,847**	14,400	14,376	12,869	11,104
	Return on average shareholders' equity	**18.6%**	14.5%	14.7%	18.0%	19.2%
Locations	Year-end *(6)*	**8,210**	8,046	7,496	6,934	5,997

(1) Includes results of Duane Reade operations since the April 9, 2010 acquisition date.

(2) Fiscal 2011, 2010 and 2009 included Rewiring for Growth restructuring and restructuring-related charges of $45 million pre-tax, $28 million after tax, or $.03 per diluted share, $106 million pre-tax, $67 million after tax, or $.07 per diluted share, and $252 million pre-tax, $160 million after tax, or $.16 per diluted share, respectively. Charges included in cost of sales for fiscal 2011, 2010 and 2009 were $3 million, $40 million and $95 million, respectively. Selling, general and administrative expenses related to the initiative for fiscal 2011, 2010 and 2009 were $42 million, $66 million and $157 million, respectively. Fiscal 2011, 2010 and 2009 included expenses related to Customer Centric Retailing store conversions of $84 million, $45 million and $5 million, respectively, all of which were included in selling, general and administrative expenses.

(3) Fiscal 2008 included a positive adjustment of $79 million pre-tax, $50 million after tax, or $.05 per diluted share, relating to an adjustment of the Company's vacation liability.

(4) In fiscal 2011, the Company sold its pharmacy benefit management business, Walgreens Health Initiatives, Inc., to Catalyst Health Solutions, Inc. and recorded a pre-tax gain of $434 million, $273 million after tax, or $.30 per diluted share.

(5) Fiscal 2010 included a deferred tax charge of $43 million related to the repeal of a tax benefit for the Medicare Part D subsidy for retiree benefits.

(6) Locations include drugstores, worksite health and wellness centers, infusion and respiratory services facilities, specialty pharmacies and mail service facilities.

Management's Discussion and Analysis of Results of Operations and Financial Condition

The following discussion and analysis of our financial condition and results of operations should be read together with the financial statements and the related notes included elsewhere herein. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in forward-looking statements. Factors that might cause a difference include, but are not limited to, those discussed under "Cautionary Note Regarding Forward-Looking Statements" below and in Item 1A (Risk Factors) in our Annual Report on Form 10-K.

Introduction

Walgreens is principally a retail drugstore chain that sells prescription and non-prescription drugs and general merchandise. General merchandise includes, among other things, household items, convenience and fresh foods, personal care, beauty care, photofinishing and candy. Customers can have prescriptions filled in retail pharmacies as well as through the mail, and customers may also place orders by telephone and online. At August 31, 2011, we operated 8,210 locations in 50 states, the District of Columbia, Guam and Puerto Rico. Total locations do not include 357 Take Care Clinics that are operated primarily within other Walgreens locations.

Number of Locations

Location Type	2011	2010	2009
Drugstores	**7,761**	7,562	6,997
Worksite Health and Wellness Centers	**355**	367	377
Infusion and Respiratory Services Facilities	**83**	101	105
Specialty Pharmacies	**9**	14	15
Mail Service Facilities	**2**	2	2
Total	**8,210**	8,046	7,496

The drugstore industry is highly competitive. In addition to other drugstore chains, independent drugstores and mail order prescription providers, we compete with various other retailers including grocery stores, convenience stores, mass merchants and dollar stores.

The Company's sales, gross profit margin and gross profit dollars are impacted by, among other things, both the percentage of prescriptions that we fill that are generic and the rate at which new generic versions are introduced to the market. In general, generic versions of drugs generate lower total sales dollars per prescription, but higher gross profit margins and gross profit dollars, as compared with patent-protected brand name drugs. The positive impact on gross profit margins and gross profit dollars has been significant in the first several months after a generic version of a drug is first allowed to compete with the branded version, which is generally referred to as a "generic conversion." In any given year, the number of major brand name drugs that undergo a conversion from branded to generic status can increase or decrease, which can have a significant impact on our sales, gross profit margins and gross profit dollars. And, because any number of factors outside of the Company's control or ability to foresee can affect timing for a generic conversion, we face substantial uncertainty in predicting when such conversions will occur and what effect they will have on particular future periods.

The long-term outlook for prescription utilization is strong due in part to the aging population, the increasing utilization of generic drugs, the continued development of innovative drugs that improve quality of life and control health care costs, and the expansion of health care insurance coverage under the Patient Protection and Affordable Care Act signed into law in 2010 (the ACA). The ACA seeks to reduce federal spending by altering the Medicaid reimbursement formula (AMP) for multi-source drugs, and when implemented, is expected to reduce Medicaid reimbursements. State Medicaid programs are also expected to continue to seek reductions in reimbursements independent of AMP. In addition, the Company continuously faces reimbursement pressure from pharmacy benefit management (PBM) companies, health maintenance organizations, managed care organizations and other commercial third party payers, and the Company's agreements with these payers are regularly subject to expiration, termination or renegotiation.

On June 21, 2011, Walgreens announced that contract renewal negotiations with pharmacy benefit manager Express Scripts, Inc. (Express Scripts) had been unsuccessful, and as a result the Company was planning not to be part of the Express Scripts pharmacy provider network as of January 1, 2012. Since then, there has been no substantive progress in the contract renewal negotiations with Express Scripts. If a contract renewal is not reached, beginning next calendar year, Express Scripts' network would no longer include Walgreens more than 7,700 pharmacies nationwide. Express Scripts, in its capacity as a pharmacy benefits manager, processed approximately 88 million prescriptions filled by Walgreens in fiscal 2011, representing approximately $5.3 billion of our sales. This development is expected to adversely affect our net sales, net income and cash flows in fiscal 2012. We intend to moderate the impact of this development on our consolidated financial results by seeking to retain business from Express Scripts' clients (consistent with their contractual obligations to Express Scripts), expand our business with other payers and customers, and implement cost saving initiatives. While the Company cannot predict what percentage of business it may retain or regain from entities and groups that were Express Scripts' clients in fiscal 2011 in any particular future period, over time, we believe employers and others will want plans with Walgreens in the network. With respect to fiscal 2012, the Company has plans in place designed to offset approximately 50 percent of any reduction in gross profit resulting from a loss of up to 75 percent of the business from Express Scripts' clients, primarily through reductions in cost of goods sold and selling, general and administrative expenses. There can be no assurance, however, that for the portion of fiscal 2012 beginning January 1, 2012, the Company will retain any particular level of business from Express Scripts' clients, and if the Company were to lose more than 75 percent of such business it is uncertain whether the Company would be able to offset as much as 50 percent of the reduction in gross profit resulting from the marginal loss of such business above 75 percent. See "Cautionary Note Regarding Forward-Looking Statements." In July 2011, Medco Health Solutions, Inc., another large pharmacy benefit manager, and Express Scripts announced an agreement to merge, completion of which is subject to regulatory and other conditions. If the merger is successfully completed, the Company may face additional reimbursement pressure or potential loss of business.

Total front-end sales have grown due to sales gains in existing stores, acquired stores and new store openings. Front-end sales have increased in the non-prescription drugs, convenience and fresh foods, personal care, beer and wine and beauty categories.

To support our growth, we are investing in prime locations, technology and customer service initiatives. We are focused on retail organic growth; however, consideration is given to retail and other acquisitions that provide unique opportunities and fit our business objectives, such as our acquisitions of drugstore.com, which enhanced our online presence, and Duane Reade, which consisted of 258 Duane Reade stores located in the New York City metropolitan area, as well as the corporate office and two distribution centers.

Restructuring

On October 30, 2008, we announced a series of strategic initiatives, approved by the Board of Directors, to enhance shareholder value. One of these initiatives was a program known as "Rewiring for Growth," which was designed to reduce cost and improve productivity through strategic sourcing of indirect spend, reducing corporate overhead and work throughout our stores, rationalization of inventory categories, and transforming community pharmacy. We completed these initiatives in the fourth quarter of fiscal 2011.

We have recorded the following pre-tax charges associated with our Rewiring for Growth program in the Consolidated Statements of Earnings *(In millions)*:

Twelve Months Ended August 31,	2011	2010	2009
Severance and other benefits	**$ 5**	$16	$ 74
Project cancellation settlements	**—**	—	7
Inventory charges	**—**	19	63
Restructuring expense	**5**	35	144
Consulting	**37**	50	76
Restructuring and restructuring-related costs	**$42**	$85	$220
Cost of sales	**$—**	$19	$ 63
Selling, general and administrative expenses	**42**	66	157
	$42	$85	$220

Severance and other benefits included the charges associated with employees who were separated from the Company. In the current fiscal year, 72 employees have been separated from the Company. Since inception, a total of 962 employees have been separated from the Company as a result of these initiatives.

Inventory charges relate to on-hand inventory that has been reduced from cost to a selling price below cost. In addition, as a part of our restructuring efforts, we sold an

incremental amount of inventory below traditional retail prices. The dilutive effect of these sales on gross profit for the years ended August 31, 2011, 2010 and 2009 was $3 million, $21 million and $32 million, respectively.

We incurred pre-tax costs of $45 million ($42 million of restructuring and restructuring-related expenses, and $3 million of gross profit dilution) in fiscal 2011. In fiscal 2010 and 2009, we incurred pre-tax costs of $106 million ($85 million of restructuring and restructuring-related costs and $21 million of gross profit dilution) and $252 million ($220 million of restructuring and restructuring-related expenses and $32 million of gross profit dilution), respectively. Since inception, we have incurred $403 million ($347 million of restructuring and restructuring-related expenses, and $56 million of gross profit dilution).

We have recorded the following balances within the accrued expenses and other liabilities section of our Consolidated Balance Sheets *(In millions)*:

	Severance and Other Benefits
August 31, 2009 Reserve Balance	$ 4
Charges	19
Cash Payments	(23)
August 31, 2010 Reserve Balance	$—
Charges	5
Cash Payments	(5)
August 31, 2011 Reserve Balance	$—

In fiscal 2011, we realized incremental savings related to the Rewiring for Growth program of approximately $354 million compared to $471 million in fiscal 2010. Selling, general and administrative expenses realized incremental savings in 2011 and 2010 of $312 million and $391 million, while cost of sales benefited by $42 million and $80 million, respectively. We have realized total savings related to Rewiring for Growth of approximately $1.1 billion compared to our base year of 2008. Selling, general and administrative expenses realized total savings of $953 million, while cost of sales benefited by approximately $122 million. The savings are primarily the result of reduced store labor and personnel reductions and expense reduction initiatives.

Additionally, as a part of the Company's Customer Centric Retailing (CCR) initiative, we are modifying the store format to enhance category layouts and adjacencies, shelf heights and sight lines, and brand and private brand assortments, all of which are designed to positively impact the shopper experience and increase customer frequency and purchase size. We expect this format will be rolled out to approximately 5,500 existing stores. At August 31, 2011, in total, we have converted 5,078 stores and opened 509 new stores with the CCR format. We expect to convert the remaining existing stores in the first quarter of fiscal 2012 and continue to open new stores with the new CCR format throughout fiscal 2012. For the remaining remodels, we expect the average total cost, which includes both selling, general and administrative expenses and capital, to be approximately $45 thousand per store. For the fiscal year ended August 31, 2011, we incurred $144 million in total program costs, of which $84 million was included in selling, general and administrative expenses and $60 million in capital costs. In fiscal 2010, we incurred $71 million in total program costs, of which $45 million was included in selling, general and administrative expenses and $26 million in capital costs. The Company incurred $5 million in program costs, all of which was included in selling, general and administrative expenses, in fiscal 2009.

Operating Statistics

	Percentage Increases/ (Decreases)		
Fiscal Year	**2011**	2010	2009
Net Sales	**7.1**	6.4	7.3
Net Earnings	**29.8**	4.2	(7.0)
Comparable Drugstore Sales	**3.3**	1.6	2.0
Prescription Sales	**6.3**	6.3	7.8
Comparable Drugstore Prescription Sales	**3.3**	2.3	3.5
Front-End Sales	**8.5**	6.8	6.3
Comparable Drugstore Front-End Sales	**3.3**	0.5	(0.5)
Gross Profit	**8.0**	7.7	5.8
Selling, General and Administrative Expenses	**6.7**	8.0	8.8

	Percent to Net Sales		
Fiscal Year	**2011**	2010	2009
Gross Margin	**28.4**	28.1	27.8
Selling, General and Administrative Expenses	**23.0**	23.0	22.7

	Other Statistics		
Fiscal Year	**2011**	2010	2009
Prescription Sales as a % of Net Sales	**64.7**	65.2	65.3
Third Party Sales as a % of Total Prescription Sales	**95.6**	95.3	95.4
Total Number of Prescriptions *(In millions)*	**718**	695	651
30-Day Equivalent Prescriptions *(In millions)**	**819**	778	723
Total Number of Locations	**8,210**	8,046	7,496

** Includes the adjustment to convert prescriptions greater than 84 days to the equivalent of three 30-day prescriptions. This adjustment reflects the fact that these prescriptions include approximately three times the amount of product days supplied compared to a normal prescription.*

Results of Operations

Fiscal year 2011 net earnings increased 29.8% to $2.7 billion, or $2.94 per diluted share, versus last year's earnings of $2.1 billion, or $2.12 per diluted share. The net earnings increase was primarily attributable to higher gross margins, the gain on the sale of our pharmacy benefit management business and a lower effective tax rate. During the fourth quarter of fiscal 2011, we sold our pharmacy benefit management business and recorded a pre-tax gain of $434 million, $273 million after tax, or $.30 per diluted share. Additionally, in fiscal 2011, we recorded pre-tax Rewiring for Growth expenses of $45 million, $28 million after tax, or $.03 per diluted share compared to pre-tax expenses of $106 million, $67 million after tax, or $.07 per diluted share last year. Duane Reade, including costs associated with the acquisition, recorded a pre-tax loss of $11 million, $7 million after tax, or $.01 per diluted share in fiscal 2011. In fiscal 2010, Duane Reade recorded a pre-tax loss of $88 million, $56 million after tax, or $.06 per diluted share, including costs associated with the acquisition. Drugstore.com, inc., which was acquired in the fourth quarter of fiscal 2011, reported a pre-tax loss of $29 million, $18 million after tax, or $.02 per diluted share, primarily due to costs related to the acquisition. In addition to the Rewiring for Growth expenses and Duane Reade loss on operations described above, fiscal 2010 earnings included a charge of $43 million, or $.04 per diluted share, from the elimination of the tax benefit for the Medicare Part D subsidy for retiree benefits that was the result of the enactment of the Patient Protection and Affordable Care Act.

Net sales increased by 7.1% to $72.2 billion in fiscal 2011 compared to increases of 6.4% in 2010 and 7.3% in 2009. The acquisition of Duane Reade increased total sales by 1.7% in the current fiscal year compared to an increase of 1.1% last year. Drugstore sales increases resulted from sales gains in existing stores and additional sales from new stores, each of which include an indeterminate amount of market-driven price changes. Sales in comparable drugstores were up 3.3% in 2011, 1.6% in 2010 and 2.0% in 2009. Comparable drugstores are defined as those that have been open for at least twelve consecutive months without closure for seven or more consecutive days and without a major remodel or a natural disaster in the past twelve months. Remodels associated with our CCR initiative are not considered major and therefore do not affect comparable drugstore results. Relocated and acquired stores (including Duane Reade) are not included as comparable stores for the first twelve months after the relocation or acquisition. We operated 8,210 locations (7,761 drugstores) at August 31, 2011, compared to 8,046 locations (7,562 drugstores) at August 31, 2010, and 7,496 (6,997 drugstores) at August 31, 2009.

Prescription sales increased 6.3% in 2011, 6.3% in 2010 and 7.8% in 2009. The acquisition of Duane Reade increased prescription sales by 1.2% in the current fiscal year versus an increase of 0.8% last year. Comparable drugstore prescription sales were up 3.3% in 2011 compared to increases of 2.3% in 2010 and 3.5% in 2009. Prescription sales as a percent of total net sales were 64.7% in 2011, 65.2% in 2010 and 65.3% in 2009. The effect of generic drugs, which have a lower retail price, replacing brand name drugs reduced prescription sales by 2.4% for 2011, 2.2% for 2010 and 3.0% for 2009, while the effect on total sales was 1.4% for 2011, 1.3% for 2010 and 1.9% for 2009. Third party sales, where reimbursement is received from managed care organizations, the government, employers or private insurers, were 95.6% of prescription sales in 2011, 95.3% in 2010 and 95.4% in 2009.

We receive market-driven reimbursements from third party payers, a number of which typically reset in January. The total number of prescriptions filled (including immunizations) was approximately 718 million in 2011, 695 million in 2010 and 651 million in 2009. Prescriptions adjusted to 30-day equivalents were 819 million in 2011, 778 million in 2010 and 723 million in 2009.

Front-end sales increased 8.5% in 2011, 6.8% in 2010 and 6.3% in 2009. The acquisition of Duane Reade increased front-end sales by 2.8% in the current year versus an increase of 1.9% last year. Additionally, the increase over the prior year is due, in part, to new store openings and improved sales related to non-prescription drugs, convenience and fresh foods and personal care products. Front-end sales were 35.3% of total sales in fiscal 2011, 34.8% of total sales in fiscal 2010 and 34.7% in fiscal 2009. Comparable drugstore front-end sales increased 3.3% in 2011 compared to an increase of 0.5% and decrease of 0.5% in fiscal years 2010 and 2009, respectively. The increase in fiscal 2011 comparable front-end sales was primarily due to non-prescription drugs, beer and wine and convenience and fresh foods, which were partially offset by decreased sales in household products.

Gross margin as a percent of sales increased to 28.4% in 2011 from 28.1% in 2010. Overall margins were positively impacted by higher front-end margins in the non-prescription drug, beauty, personal care and convenience and fresh food categories. Retail pharmacy margins were also higher as the positive effect of generic drug sales more than offset market-driven reimbursements and the first quarter write-down of flu shot inventory. These positive effects were partially offset by a higher provision for LIFO. Gross margin as a percent of sales was 28.1% in 2010 as compared to 27.8% in 2009. Overall margins were positively impacted by higher front-end margins due to pricing, promotion and other improved efficiencies and lower Rewiring for Growth costs. Retail pharmacy margins benefited from the positive impact of generic drug introductions but were partially offset by market-driven reimbursement rates.

We use the last-in, first-out (LIFO) method of inventory valuation. The LIFO provision is dependent upon inventory levels, inflation rates and merchandise mix. The effective LIFO inflation rates were 2.39% in 2011, 1.70% in 2010, and 2.00% in 2009, which resulted in charges to cost of sales of $208 million in 2011, $140 million in 2010 and $172 million in 2009. Inflation on prescription inventory was 4.64% in 2011, 4.72% in 2010 and 2.40% in 2009. In fiscal years 2010 and 2009, we experienced deflation in some non-prescription inventories. The anticipated LIFO inflation rate for fiscal 2012 is 2.00%.

Selling, general and administrative expenses were 23.0% of sales in fiscal 2011 and 2010, and 22.7% in fiscal 2009. In the current fiscal year, increased corporate costs and Duane Reade operational expenses were offset by lower Rewiring for Growth costs and incremental savings from our Rewiring for Growth activities, primarily from expense reduction initiatives and reduced store payroll, as a percentage of sales. The increase in fiscal 2010 as compared to fiscal 2009 was attributed to higher occupancy expense, Duane Reade operational expenses and costs associated with the Duane Reade acquisition. These expenses were partially offset by lower Rewiring for Growth costs and advertising expense. Also positively impacting fiscal 2010 selling, general and administrative expenses was incremental savings from our Rewiring for Growth activities, primarily from expense reduction initiatives and reduced store payroll.

Interest was a net expense of $71 million in fiscal 2011, $85 million in fiscal 2010 and $83 million in fiscal 2009. Interest expense for fiscal 2011, 2010 and 2009 is net of $10 million, $12 million and $16 million, respectively, that was capitalized to construction projects. The decrease in net interest expense from fiscal 2010 to fiscal 2011 is primarily attributed to reduced interest rates associated with our fixed to variable interest rate swaps.

The effective income tax rate was 36.8% for fiscal 2011, 38.0% for 2010, and 36.6% for 2009. Fiscal 2010 included a $43 million charge to deferred taxes for the repeal of the tax benefit for the Medicare Part D subsidy for retiree benefits. Excluding this adjustment, the effective rate for fiscal 2010 was 36.7%. We anticipate an effective tax rate of approximately 37.3% in fiscal 2012.

Critical Accounting Policies

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and include amounts based on management's prudent judgments and estimates. Actual results may differ from these estimates. Management believes that any reasonable deviation from those judgments and estimates would not have a material impact on our consolidated financial position or results of operations. To the extent that the estimates used differ from actual results, however, adjustments to the statement of earnings and corresponding balance sheet accounts would be necessary. These adjustments would be made in future statements. Some of the more significant estimates include goodwill and other intangible asset impairment, allowance for doubtful accounts, vendor allowances, asset impairments, liability for closed locations, liability for insurance claims, cost of sales and income taxes. We use the following methods to determine our estimates:

Goodwill and other intangible asset impairment – Goodwill and other indefinite-lived intangible assets are not amortized, but are evaluated for impairment annually during the fourth quarter, or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. As part of our impairment analysis for each reporting unit, we engage a third party appraisal firm to assist in the determination of estimated fair value for each unit. This determination includes estimating the fair value using both the income and market approaches. The income approach requires management to estimate a number of factors for each reporting unit, including projected future operating results, economic projections, anticipated future cash flows and discount rates. The market approach estimates fair value using comparable marketplace fair value data from within a comparable industry grouping.

The determination of the fair value of the reporting units and the allocation of that value to individual assets and liabilities within those reporting units requires us to make significant estimates and assumptions. These estimates and assumptions primarily include, but are not limited to: the selection of appropriate peer group companies; control premiums appropriate for acquisitions in the industries in which we compete; the discount rate; terminal growth rates; and forecasts of revenue, operating income, depreciation and amortization and capital expenditures. The allocation requires several analyses to determine fair value of assets and liabilities including, among other things, purchased prescription files, customer relationships and trade names. Although we believe our estimates of fair value are reasonable, actual financial results could differ from those estimates due to the inherent uncertainty involved in making such estimates. Changes in assumptions concerning future financial results or other underlying assumptions could have a significant impact on either the fair value of the reporting units, the amount of the goodwill impairment charge, or both.

We also compared the sum of the estimated fair values of the reporting units to the Company's total value as implied by the market value of the Company's equity and debt securities. This comparison indicated that, in total, our assumptions and estimates were reasonable. However, future declines in the overall market value of the Company's equity and debt securities may indicate that the fair value of one or more reporting units has declined below its carrying value.

One measure of the sensitivity of the amount of goodwill impairment charges to key assumptions is the amount by which each reporting unit "passed" (fair value exceeds the carrying amount) or "failed" (the carrying amount exceeds fair value) the first step of the goodwill impairment test. Our reporting units' fair values exceeded their carrying amounts by 5% to more than 300%. The fair values for two reporting units each exceeded their carrying amounts by 10% or less. Goodwill allocated to these reporting units was $173 million at May 31, 2011. For each of these reporting units, relatively small changes in the Company's key assumptions may have resulted in the recognition of significant goodwill impairment charges. Our Long Term Care Pharmacy's goodwill was impaired by $16 million in fiscal 2010 as a result of the asset sale agreement with Omnicare, Inc., which was signed on August 31, 2010.

Generally, changes in estimates of expected future cash flows would have a similar effect on the estimated fair value of the reporting unit. That is, a 1% change in estimated future cash flows would decrease the estimated fair value of the reporting unit by approximately 1%. The estimated long-term rate of net sales growth can have a significant impact on the estimated future cash flows, and therefore, the fair value of each reporting unit. For the two reporting units whose fair values exceeded carrying values by 10% or less, a 1% decrease in the long-term net sales growth rate would have resulted in the reporting units failing the first step of the goodwill impairment test. Of the other key assumptions that impact the estimated fair values, most reporting units have the greatest sensitivity to changes

in the estimated discount rate. A 1% increase in estimated discount rates for the two reporting units whose fair value exceeded carrying value by 10% or less would also have resulted in the reporting units failing step one. The Company believes that its estimates of future cash flows and discount rates are reasonable, but future changes in the underlying assumptions could differ due to the inherent uncertainty in making such estimates.

We have not made any material changes to the method of evaluating goodwill and intangible asset impairments during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine impairment.

Allowance for doubtful accounts – The provision for bad debt is based on both specific receivables and historic write-off percentages. We have not made any material changes to the method of estimating our allowance for doubtful accounts during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine the allowance.

Vendor allowances – Vendor allowances are principally received as a result of purchases, sales or promotion of vendors' products. Allowances are generally recorded as a reduction of inventory and are recognized as a reduction of cost of sales when the related merchandise is sold. Those allowances received for promoting vendors' products are offset against advertising expense and result in a reduction of selling, general and administrative expenses to the extent of advertising incurred, with the excess treated as a reduction of inventory costs. We have not made any material changes to the method of estimating our vendor allowances during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine vendor allowances.

Asset impairments – The impairment of long-lived assets is assessed based upon both qualitative and quantitative factors, including years of operation and expected future cash flows, and tested for impairment annually or whenever events or circumstances indicate that a certain asset may be impaired. If the future cash flows reveal that the carrying value of the asset group may not be recoverable, an impairment charge is immediately recorded. We have not made any material changes to the method of estimating our asset impairments during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine asset impairments.

Liability for closed locations – The liability is based on the present value of future rent obligations and other related costs (net of estimated sublease rent) to the first lease option date. We have not made any material changes to the method of estimating our liability for closed locations during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine the liability.

Liability for insurance claims – The liability for insurance claims is recorded based on estimates for claims incurred and is not discounted. The provisions are estimated in part by considering historical claims experience, demographic factors and other actuarial assumptions. We have not made any material changes to the method of estimating our liability for insurance claims during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine the liability.

Cost of sales – Drugstore cost of sales is derived based on point-of-sale scanning information with an estimate for shrinkage and adjusted based on periodic inventory counts. Inventories are valued at the lower of cost or market determined by the last-in, first-out (LIFO) method. We have not made any material changes to the method of estimating cost of sales during the last three years. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine cost of sales.

Income taxes – We are subject to routine income tax audits that occur periodically in the normal course of business. U.S. federal, state and local and foreign tax authorities raise questions regarding our tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. In evaluating the tax benefits associated with our various tax filing positions, we record a tax benefit for uncertain tax positions using the highest cumulative tax benefit that is more likely than not to be realized. Adjustments are made to our liability for unrecognized tax benefits in the period in which we determine the issue is effectively settled with the tax authorities, the statute of limitations expires for the return containing the tax position or when more information becomes available. Our liability for unrecognized tax benefits, including accrued penalties and interest, is included in other long-term liabilities on our consolidated balance sheets and in income tax expense in our consolidated statements of earnings.

In determining our provision for income taxes, we use an annual effective income tax rate based on full-year income, permanent differences between book and tax income, and statutory income tax rates. The effective income tax rate also reflects our assessment of the ultimate outcome of tax audits. Discrete events such as audit settlements or changes in tax laws are recognized in the period in which they occur. Based on current knowledge, we do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to determine the amounts recorded for income taxes.

Liquidity and Capital Resources

Cash and cash equivalents were $1.6 billion at August 31, 2011, compared to $1.9 billion at August 31, 2010. Short-term investment objectives are to minimize risk, maintain liquidity and maximize after-tax yields. To attain these objectives, investment limits are placed on the amount, type and issuer of securities. Investments are principally in money market funds, U.S. Treasury market funds and Treasury Bills.

On October 14, 2009, our Board of Directors approved a long-term capital policy: to maintain a strong balance sheet and financial flexibility; reinvest in our core strategies; invest in strategic opportunities that reinforce our core strategies and meet return requirements; and return surplus cash flow to shareholders in the form of dividends and share repurchases over the long term.

Net cash provided by operating activities was $3.6 billion at August 31, 2011, compared to $3.7 billion a year ago. The decrease from the prior year is primarily attributable to higher working capital. For the year, working capital was a cash flow use of $155 million as compared to the prior year where working capital improvements generated a cash flow of $306 million. Partially offsetting the cash flow decrease in working capital were higher earnings which positively contributed to cash from operations. Cash provided by operations is the principal source of funds for expansion, acquisitions, remodeling programs, dividends to shareholders and stock repurchases.

Net cash used for investing activities was $1.5 billion versus $1.3 billion last year. Additions to property and equipment were $1.2 billion compared to $1.0 billion last year. In fiscal 2011, we added a total of 297 locations (164 net) compared to last year's 670 locations (550 net), which included the acquisition of 258 Duane Reade locations. There were 62 owned locations added during the year and 44 under construction at August 31, 2011, versus 95 owned locations added and 65 under construction as of August 31, 2010.

	Drugstores	Work-sites	Infusion and Respiratory Services	Specialty Pharmacy	Mail Service	Total
August 31, 2009	6,997	377	105	15	2	7,496
New/Relocated	359	24	4	1	—	388
Acquired	281	—	1	—	—	282
Closed/Replaced	(75)	(34)	(9)	(2)	—	(120)
August 31, 2010	7,562	367	101	14	2	8,046
New/Relocated	237	21	1	2	—	261
Acquired	32	—	4	—	—	36
Closed/Replaced	(70)	(33)	(23)	(7)	—	(133)
August 31, 2011	7,761	355	83	9	2	8,210

Business acquisitions this year were $630 million versus $779 million in fiscal 2010. Business acquisitions in the current year included the purchase of drugstore.com, inc., for $398 million net of assumed cash, $29 million of infusion and respiratory services assets and selected other assets (primarily prescription files). Business acquisitions in 2010 included the purchase of all 258 Duane Reade stores located in the New York City

metropolitan area, as well as the corporate office and two distribution centers for $560 million net of assumed cash; and selected other assets (primarily prescription files). In the current year, we sold our pharmacy benefit management business, Walgreens Health Initiatives, Inc. (WHI) and recorded net cash proceeds of $442 million. Additionally, in the current year we established a restricted cash account of $191 million to support certain insurance obligations. In fiscal year 2010, our insurance obligations were supported by letters of credit which were released in the current fiscal year upon establishing the restricted cash account.

Capital expenditures for fiscal 2012 are currently expected to be approximately $1.6 billion, excluding business acquisitions and prescription file purchases, although the actual amount may vary depending upon a variety of factors, including, among other things, the timing of implementation of certain capital projects. We expect new drugstore organic growth of between 2.5% and 3.0% in fiscal 2012. During the current fiscal year, we added a total of 297 locations, of which 269 were new or relocated drugstores. We are continuing to relocate stores to more convenient and profitable freestanding locations.

Net cash used for financing activities was $2.4 billion compared to the prior year's net cash use of $2.7 billion. We repurchased shares totaling $2.0 billion in the current year, $1.8 billion in conjunction with our share buyback programs and $244 million to support the needs of the employee stock plans. In the prior year, we repurchased shares totaling $1.8 billion, $1.6 billion in conjunction with our share buyback programs and $116 million to support the needs of the employee stock plans. We had proceeds related to employee stock plans of $235 million compared to $233 million last year. Cash dividends paid were $647 million versus $541 million a year ago.

In connection with our capital policy, our Board of Directors authorized a share repurchase program (2009 repurchase program) and set a long-term dividend payout ratio target between 30 and 35 percent of net earnings. The 2009 repurchase program, which was completed in September 2010, allowed for the repurchase of up to $2.0 billion of the Company's common stock. For the fiscal years ended August 31, 2011 and 2010, shares totaling $360 million and $1.6 billion were purchased in conjunction with the 2009 repurchase program, respectively. On October 13, 2010, our Board of Directors authorized the 2011 repurchase program, which was completed in July 2011, which allowed for the repurchase of up to $1.0 billion of the Company's common stock. On July 13, 2011, our Board of Directors authorized the 2012 repurchase program, which allows for the repurchase of up to $2.0 billion of the Company's common stock prior to its expiration on December 31, 2015. Shares totaling $424 million were purchased in fiscal 2011 related to the 2012 program. We determine the timing and amount of repurchases based on our assessment of various factors including prevailing market conditions, alternate uses of capital, liquidity, the economic environment and other factors. The timing and amount of these purchases may change at any time and from time to time. The Company has, and may from time to time in the future, repurchase shares on the open market through Rule 10b5-1 plans, which enable a company to repurchase shares at times when it otherwise might be precluded from doing so under insider trading laws.

We had no commercial paper outstanding at August 31, 2011. In connection with our commercial paper program, we maintain two unsecured backup syndicated lines of credit that total $1.1 billion. The first $500 million facility expires on July 20, 2015, and allows for the issuance of up to $250 million in letters of credit, which reduce the amount available for borrowing. The second $600 million facility expires on August 13, 2012. Our ability to access these facilities is subject to our compliance with the terms and conditions of the credit facility, including financial covenants. The covenants require us to maintain certain financial ratios related to minimum net worth and priority debt, along with limitations on the sale of assets and purchases of investments. At August 31, 2011, we were in compliance with all such covenants. The Company pays a facility fee to the financing banks to keep these lines of credit active. At August 31, 2011, there were no letters of credit issued against these facilities and we do not anticipate any future letters of credit to be issued against these facilities.

On October 25, 2011, our credit ratings were:

Rating Agency	Long-Term Debt Rating	Commercial Paper Rating	Outlook
Moody's	A2	P-1	Negative
Standard & Poor's	A	A-1	Negative

In assessing our credit strength, both Moody's and Standard & Poor's consider our business model, capital structure, financial policies and financial statements. Our credit ratings impact our borrowing costs, access to capital markets and operating lease costs.

Contractual Obligations and Commitments

The following table lists our contractual obligations and commitments at August 31, 2011 *(In millions)*:

		Payments Due by Period			
	Total	Less Than 1 Year	1–3 Years	3–5 Years	Over 5 Years
Operating leases *(1)*	$36,205	$ 2,381	$4,715	$4,492	$ 24,617
Purchase obligations *(2)*:					
Open inventory purchase orders	1,736	1,736	—	—	—
Real estate development	240	155	77	8	—
Other corporate obligations	494	244	142	88	20
Long-term debt* *(3)*	2,353	8	1,305	9	1,031
Interest payment on long-term debt	523	116	168	105	134
Insurance*	570	226	166	76	102
Retiree health*	407	11	26	32	338
Closed location obligations*	145	33	38	23	51
Capital lease obligations* *(1)*	113	5	10	7	91
Other long-term liabilities reflected on the balance sheet* *(4)*	889	64	172	151	502
Total	$43,675	$ 4,979	$6,819	$4,991	$ 26,886

* *Recorded on balance sheet.*

(1) *Amounts for operating leases and capital leases do not include certain operating expenses under these leases such as common area maintenance, insurance and real estate taxes. These expenses were $404 million for the fiscal year ended August 31, 2011.*

(2) *Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding and that specify all significant terms, including open purchase orders.*

(3) *Total long-term debt on the Consolidated Balance Sheet includes a $57 million fair market value adjustment and $6 million of unamortized discount.*

(4) *Includes $101 million ($40 million in 1–3 years, $45 million in 3–5 years and $16 million over 5 years) of unrecognized tax benefits recorded under Accounting Standards Codification (ASC) Topic 740, Income Taxes.*

The expected timing of payments of the obligations above is estimated based on current information. Timing of payments and actual amounts paid may be different, depending on the time of receipt of goods or services, or changes to agreed-upon amounts for some obligations.

Off-Balance Sheet Arrangements

We do not have any unconsolidated special purpose entities and, except as described herein, we do not have significant exposure to any off-balance sheet arrangements. The term "off-balance sheet arrangement" generally means any transaction, agreement or other contractual arrangement to which an entity unconsolidated with us is a party, under which we have: (i) any obligation arising under a guarantee contract, derivative instrument or variable interest; or (ii) a retained or contingent interest in assets transferred to such entity or similar arrangement that serves as credit, liquidity or market risk support for such assets.

Letters of credit are issued to support purchase obligations and commitments (as reflected on the Contractual Obligations and Commitments table) as follows *(In millions)*:

Inventory obligations	$143
Insurance	40
Real estate development	13
Total	$196

In addition to issued letters of credit, we held $191 million of restricted cash to support certain insurance obligations at August 31, 2011. In fiscal year 2010, our insurance obligations were supported by letters of credit, some of which were subsequently released in the current fiscal year upon establishing a restricted cash account.

We have no off-balance sheet arrangements other than those disclosed on the Contractual Obligations and Commitments table. Both on-balance sheet and off-balance sheet financing alternatives are considered when pursuing our capital structure and capital allocation objectives.

Recent Accounting Pronouncements

In August 2010, the Financial Accounting Standards Board (FASB) issued an exposure draft on lease accounting that would require entities to recognize assets and liabilities arising from lease contracts on the balance sheet. The proposed exposure draft states that lessees and lessors should apply a "right-of-use model" in accounting for all leases. Under the proposed model, lessees would recognize an asset for the right to use the leased asset, and a liability for the obligation to make rental payments over the lease term. The lease term is defined as the longest possible term that is "more likely than not" to occur. The accounting by a lessor would reflect its retained exposure to the risks or benefits of the underlying leased asset. A lessor would recognize an asset representing its right to receive lease payments based on the expected term of the lease. On the basis of feedback received from comment letters, roundtables, and outreach sessions, the FASB has made significant changes to the proposals in the exposure draft and therefore has decided to re-expose the revised exposure draft in the first quarter of 2012. The proposed standard, as currently drafted, will have a material impact on the Company's reported results of operations and financial position. The impact of this exposure draft is non-cash in nature and will not affect the Company's cash position.

On June 16, 2011, the FASB issued Accounting Standards Update (ASU) 2011-05, Presentation of Comprehensive Income. ASU 2011-05 requires entities to present the total of comprehensive income, the components of net income and the components of other comprehensive income in either (1) a single continuous statement of comprehensive income or (2) two separate but consecutive statements. The ASU does not change the items that are required to be reported in other comprehensive income. The ASU is effective for interim and annual periods beginning after December 15, 2011, and will be applied retrospectively. The Company is still evaluating which of the two alternatives it will apply in reporting comprehensive income. Neither alternative will have a material impact on the Company's results of operations or financial position.

On September 15, 2011, the FASB issued ASU 2011-08, Intangibles – Goodwill and Other, which simplifies how an entity is required to test goodwill for impairment. This ASU would allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under the ASU, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The ASU includes a number of factors to consider in conducting the qualitative assessment. The ASU is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. This standard is not expected to have a material impact on the Company's reported results of operations or financial position.

Cautionary Note Regarding Forward-Looking Statements

This report and other documents that we file or furnish with the Securities and Exchange Commission contain forward-looking statements that are based on current expectations, estimates, forecasts and projections about our future performance, our business, our beliefs and our management's assumptions. Statements that are not historical facts are forward-looking statements, including forward-looking information concerning pharmacy sales trends, prescription margins, number and location of new store openings, vendor, payer and customer relationships and terms, possible new contracts or contract extensions, competition, economic and business conditions, outcomes of litigation and regulatory matters, the level of capital expenditures, industry trends, demographic trends, growth strategies, financial results, cost reduction initiatives, acquisition synergies, competitive strengths and changes in legislation or regulations. Words such as "expect," "likely," "outlook," "forecast," "would," "could," "should," "can," "will," "project," "intend," "plan," "continue," "sustain," "on track," "believe," "seek," "estimate," "anticipate," "may," "possible," "assume," variations of such words and similar expressions are intended to identify such forward-looking statements, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not guarantees of future performance and involve risks, assumptions and uncertainties, including, but not limited to, those relating to changes in vendor, payer and customer relationships and terms, competition, changes in economic and business conditions generally or in the markets we serve, risks associated with new business initiatives and activities, the failure to obtain new contracts or extensions of existing contracts, the availability and cost of real estate and construction, risks associated with acquisitions and divestitures, the ability to realize anticipated results from capital expenditures and cost reduction initiatives, outcomes of legal and regulatory matters, changes in legislation or regulations or interpretations thereof, and those described in Item 1A "Risk Factors" in our Form 10-K and in other reports that we file or furnish with the Securities and Exchange Commission. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those indicated or anticipated by such forward-looking statements. Accordingly, you are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date they are made. Except to the extent required by law, we do not undertake, and expressly disclaim, any duty or obligation to update publicly any forward-looking statement after the date the statement is made, whether as a result of new information, future events, changes in assumptions or otherwise.

Consolidated Statements of Earnings

Walgreen Co. and Subsidiaries for the years ended August 31, 2011, 2010, and 2009 *(In millions, except per share amounts)*

Earnings	2011	2010	2009
Net sales	**$72,184**	$67,420	$63,335
Cost of sales	**51,692**	48,444	45,722
Gross Profit	**20,492**	18,976	17,613
Selling, general and administrative expenses	**16,561**	15,518	14,366
Gain on sale of business	**434**	—	—
Operating Income	**4,365**	3,458	3,247
Interest expense, net	**(71)**	(85)	(83)
Earnings Before Income Tax Provision	**4,294**	3,373	3,164
Income tax provision	**1,580**	1,282	1,158
Net Earnings	**$ 2,714**	$ 2,091	$ 2,006
Net earnings per common share – basic	**$ 2.97**	$ 2.13	$ 2.03
Net earnings per common share – diluted	**2.94**	2.12	2.02
Average shares outstanding	**915.1**	981.7	990.0
Dilutive effect of stock options	**9.4**	6.2	1.3
Average diluted shares	**924.5**	987.9	991.3

The accompanying Notes to Consolidated Financial Statements are integral parts of these statements.

Consolidated Statements of Shareholders' Equity

Walgreen Co. and Subsidiaries for the years ended August 31, 2011, 2010 and 2009 *(In millions, except shares and per share amounts)*

	Common Stock Shares	Common Stock Amount	Paid-In Capital	Employee Stock Loan Receivable	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock Amount
Balance, August 31, 2008	989,176,218	$80	$575	$ (36)	$ 13,792	$ 9	$ (1,551)
Net earnings	—	—	—	—	2,006	—	—
Dividends declared ($.4750 per share)	—	—	—	—	(471)	—	—
Treasury stock purchases	(10,270,000)	—	—	—	—	—	(279)
Employee stock purchase and option plans	9,655,172	—	(48)	—	—	—	297
Stock-based compensation	—	—	78	—	—	—	—
Employee stock loan receivable	—	—	—	(104)	—	—	—
Additional minimum postretirement liability, net of $29 tax expense	—	—	—	—	—	28	—
Balance, August 31, 2009	988,561,390	80	605	(140)	15,327	37	(1,533)
Net earnings	—	—	—	—	2,091	—	—
Dividends declared ($.5875 per share)	—	—	—	—	(570)	—	—
Treasury stock purchases	(55,716,733)	—	—	—	—	—	(1,756)
Employee stock purchase and option plans	5,760,396	—	(5)	—	—	—	188
Stock-based compensation	—	—	84	—	—	—	—
Employee stock loan receivable	—	—	—	53	—	—	—
Additional minimum postretirement liability, net of $34 tax benefit	—	—	—	—	—	(61)	—
Balance, August 31, 2010	938,605,053	80	684	(87)	16,848	(24)	(3,101)
Net earnings	**—**	**—**	**—**	**—**	**2,714**	**—**	**—**
Dividends declared ($.7500 per share)	**—**	**—**	**—**	**—**	**(685)**	**—**	**—**
Treasury stock purchases	**(54,739,474)**	**—**	**—**	**—**	**—**	**—**	**(2,028)**
Employee stock purchase and option plans	**5,428,551**	**—**	**(12)**	**—**	**—**	**—**	**203**
Other	**—**	**—**	**27**	**—**	**—**	**—**	**—**
Stock-based compensation	**—**	**—**	**135**	**—**	**—**	**—**	**—**
Employee stock loan receivable	**—**	**—**	**—**	**53**	**—**	**—**	**—**
Additional minimum postretirement liability, net of $22 tax expense	**—**	**—**	**—**	**—**	**—**	**40**	**—**
Balance, August 31, 2011	**889,294,130**	**$80**	**$834**	**$ (34)**	**$ 18,877**	**$ 16**	**$(4,926)**

The accompanying Notes to Consolidated Financial Statements are integral parts of these statements.

Consolidated Balance Sheets

Walgreen Co. and Subsidiaries at August 31, 2011 and 2010 *(In millions, except shares and per share amounts)*

Assets		**2011**	2010
Current Assets	Cash and cash equivalents	**$ 1,556**	$ 1,880
	Accounts receivable, net	**2,497**	2,450
	Inventories	**8,044**	7,378
	Other current assets	**225**	214
	Total Current Assets	**12,322**	11,922
Non-Current Assets	Property and equipment, at cost, less accumulated depreciation and amortization	**11,526**	11,184
	Goodwill	**2,017**	1,887
	Other non-current assets	**1,589**	1,282
	Total Non-Current Assets	**15,132**	14,353
	Total Assets	**$27,454**	$26,275

Liabilities and Shareholders' Equity			
Current Liabilities	Short-term borrowings	**$ 13**	$ 12
	Trade accounts payable	**4,810**	4,585
	Accrued expenses and other liabilities	**3,075**	2,763
	Income taxes	**185**	73
	Total Current Liabilities	**8,083**	7,433
Non-Current Liabilities	Long-term debt	**2,396**	2,389
	Deferred income taxes	**343**	318
	Other non-current liabilities	**1,785**	1,735
	Total Non-Current Liabilities	**4,524**	4,442
	Commitments and Contingencies (see Note 10)		
Shareholders' Equity	Preferred stock, $.0625 par value; authorized 32 million shares; none issued	**—**	—
	Common stock, $.078125 par value; authorized 3.2 billion shares; issued 1,025,400,000 shares in 2011 and 2010	**80**	80
	Paid-in capital	**834**	684
	Employee stock loan receivable	**(34)**	(87)
	Retained earnings	**18,877**	16,848
	Accumulated other comprehensive income (loss)	**16**	(24)
	Treasury stock at cost, 136,105,870 shares in 2011 and 86,794,947 shares in 2010	**(4,926)**	(3,101)
	Total Shareholders' Equity	**14,847**	14,400
	Total Liabilities and Shareholders' Equity	**$27,454**	$26,275

The accompanying Notes to Consolidated Financial Statements are integral parts of these statements.

Consolidated Statements of Cash Flows

Walgreen Co. and Subsidiaries for the years ended August 31, 2011, 2010 and 2009 *(In millions)*

		2011	2010	2009
Cash Flows from Operating Activities	Net earnings	**$2,714**	$2,091	$2,006
	Adjustments to reconcile net earnings to net cash provided by operating activities –			
	Depreciation and amortization	**1,086**	1,030	975
	Gain on sale of business	**(434)**	—	—
	Deferred income taxes	**132**	63	260
	Stock compensation expense	**135**	84	84
	Other	**53**	60	13
	Changes in operating assets and liabilities –			
	Accounts receivable, net	**(243)**	124	6
	Inventories	**(592)**	(307)	533
	Other assets	**(24)**	50	7
	Trade accounts payable	**384**	167	11
	Accrued expenses and other liabilities	**218**	262	66
	Income taxes	**102**	10	105
	Other non-current liabilities	**112**	110	45
	Net cash provided by operating activities	**3,643**	3,744	4,111
Cash Flows from Investing Activities	Purchases of short-term investments – held to maturity	**—**	(3,000)	(2,600)
	Proceeds from short-term investments – held to maturity	**—**	3,500	2,100
	Investment in restricted cash	**(191)**	—	—
	Additions to property and equipment	**(1,213)**	(1,014)	(1,927)
	Proceeds from sale of assets	**79**	51	51
	Business and intangible asset acquisitions, net of cash received	**(630)**	(779)	(405)
	Proceeds from sale of business	**442**	—	—
	Other	**(12)**	(32)	5
	Net cash used for investing activities	**(1,525)**	(1,274)	(2,776)
Cash Flows from Financing Activities	Net payment from short-term borrowings	**—**	—	(70)
	Net proceeds from issuance of long-term debt	**—**	—	987
	Payments of long-term debt	**(17)**	(576)	—
	Stock purchases	**(2,028)**	(1,756)	(279)
	Proceeds related to employee stock plans	**235**	233	138
	Cash dividends paid	**(647)**	(541)	(446)
	Other	**15**	(37)	(21)
	Net cash (used for) provided by financing activities	**(2,442)**	(2,677)	309
Changes in Cash and Cash Equivalents	Net (decrease) increase in cash and cash equivalents	**(324)**	(207)	1,644
	Cash and cash equivalents at beginning of year	**1,880**	2,087	443
	Cash and cash equivalents at end of year	**$1,556**	$1,880	$2,087

The accompanying Notes to Consolidated Financial Statements are integral parts of these statements.

Notes to Consolidated Financial Statements

1. Summary of Major Accounting Policies

Description of Business

The Company is principally in the retail drugstore business and its operations are within one reportable segment. At August 31, 2011, there were 8,210 drugstore and other locations in 50 states, the District of Columbia, Guam and Puerto Rico. Prescription sales were 64.7% of total sales for fiscal 2011 compared to 65.2% in 2010 and 65.3% in 2009.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany transactions have been eliminated. The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and include amounts based on management's prudent judgments and estimates. Actual results may differ from these estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and all highly liquid investments with an original maturity of three months or less. Credit and debit card receivables from banks, which generally settle within two business days, of $83 million and $80 million were included in cash and cash equivalents at August 31, 2011 and 2010, respectively. At August 31, 2011 and 2010, the Company had $1,239 million and $1,030 million, respectively, in money market funds, all of which was included in cash and cash equivalents. The Company did not invest in U.S. Treasury Bills at August 31, 2011, compared to $600 million at August 31, 2010, which was included in cash and cash equivalents.

The Company's cash management policy provides for controlled disbursement. As a result, the Company had outstanding checks in excess of funds on deposit at certain banks. These amounts, which were $229 million at August 31, 2011, and $235 million at August 31, 2010, are included in trade accounts payable in the accompanying Consolidated Balance Sheets.

The Company holds restricted cash to support certain insurance obligations. Restricted cash at August 31, 2011, was $191 million and is recorded within other non-current assets within the Consolidated Balance Sheets. In fiscal year 2010, insurance obligations were supported by issued letters of credit, some of which were subsequently released in the current fiscal year upon establishing a restricted cash account.

Financial Instruments

The Company had $143 million and $185 million of outstanding letters of credit at August 31, 2011 and 2010, respectively, which guarantee the purchase of foreign goods, and additional outstanding letters of credit of $40 million and $233 million at August 31, 2011 and 2010, respectively, which guarantee payments of insurance claims. The insurance claim letters of credit are annually renewable and will remain in place until the insurance claims are paid in full. In the current fiscal year, the Company began using restricted cash to secure some of its insurance claims. Letters of credit of $13 million and $19 million were outstanding at August 31, 2011, and August 31, 2010, respectively, to guarantee performance of construction contracts. The Company pays a facility fee to the financing bank to keep these letters of credit active. The Company had real estate development purchase commitments of $240 million and $370 million at August 31, 2011 and 2010, respectively.

The Company uses interest rate swaps to manage its interest rate exposure associated with some of its fixed rate borrowings. At August 31, 2011, $1,550 million of fixed rate debt was converted to variable rate. These swaps are accounted for according to ASC Topic 815, Derivatives and Hedging. The swaps are measured at fair value in accordance with ASC Topic 820, Fair Value Measurement and Disclosures. See Notes 8 and 9 for additional disclosure regarding financial instruments.

Inventories

Inventories are valued on a lower of last-in, first-out (LIFO) cost or market basis. At August 31, 2011 and 2010, inventories would have been greater by $1,587 million and $1,379 million, respectively, if they had been valued on a lower of first-in, first-out (FIFO) cost or market basis. Inventory includes product costs, inbound freight, warehousing costs and vendor allowances not classified as a reduction of advertising expense.

Cost of Sales

Cost of sales is derived based upon point-of-sale scanning information with an estimate for shrinkage and is adjusted based on periodic inventories. In addition to product costs, cost of sales includes warehousing costs, purchasing costs, freight costs, cash discounts and vendor allowances.

Selling, General and Administrative Expenses

Selling, general and administrative expenses mainly consist of store salaries, occupancy costs, and expenses directly related to stores. Other administrative costs include headquarters' expenses, advertising costs (net of advertising revenue) and insurance.

Vendor Allowances

Vendor allowances are principally received as a result of purchases, sales or promotion of vendors' products. Allowances are generally recorded as a reduction of inventory and are recognized as a reduction of cost of sales when the related merchandise is sold. Those allowances received for promoting vendors' products are offset against advertising expense and result in a reduction of selling, general and administrative expenses to the extent of advertising costs incurred, with the excess treated as a reduction of inventory costs.

Property and Equipment

Depreciation is provided on a straight-line basis over the estimated useful lives of owned assets. Leasehold improvements and leased properties under capital leases are amortized over the estimated useful life of the property or over the term of the lease, whichever is shorter. Estimated useful lives range from 10 to 39 years for land improvements, buildings and building improvements; and 3 to 12 1/2 years for equipment. Major repairs, which extend the useful life of an asset, are capitalized; routine maintenance and repairs are charged against earnings. The majority of the business uses the composite method of depreciation for equipment. Therefore, gains and losses on retirement or other disposition of such assets are included in earnings only when an operating location is closed, completely remodeled or impaired. Fully depreciated property and equipment are removed from the cost and related accumulated depreciation and amortization accounts.

Property and equipment consists of *(In millions)*:

	2011	2010
Land and land improvements		
Owned locations	**$ 3,209**	$ 3,135
Distribution centers	**96**	103
Other locations	**240**	233
Buildings and building improvements		
Owned locations	**3,651**	3,442
Leased locations (leasehold improvements only)	**1,235**	1,099
Distribution centers	**596**	592
Other locations	**372**	343
Equipment		
Locations	**4,468**	4,126
Distribution centers	**1,098**	1,106
Other locations	**423**	410
Capitalized system development costs	**328**	333
Capital lease properties	**118**	97
	15,834	15,019
Less: accumulated depreciation and amortization	**4,308**	3,835
	$11,526	$11,184

Depreciation expense for property and equipment was $809 million in fiscal 2011, $804 million in fiscal 2010 and $787 million in fiscal 2009.

The Company capitalizes application stage development costs for significant internally developed software projects, such as upgrades to the store point of sale system. These costs are amortized over a five-year period. Amortization was $58 million in fiscal 2011, $44 million in fiscal 2010 and $40 million in fiscal 2009. Unamortized costs at August 31, 2011 and 2010, were $230 million and $244 million, respectively.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of assets acquired and liabilities assumed. The Company accounts for goodwill and intangibles under ASC Topic 350, Intangibles – Goodwill and Other, which does not permit amortization, but requires the Company to test goodwill and other indefinite-lived assets for impairment annually or whenever events or circumstances indicate impairment may exist.

Revenue Recognition

The Company recognizes revenue at the time the customer takes possession of the merchandise. Customer returns are immaterial. Sales taxes are not included in revenue.

The services the Company provided to its pharmacy benefit management (PBM) clients included: plan set-up, claims adjudication with network pharmacies, formulary management, and reimbursement services. Through its PBM, the Company acted as an agent in administering pharmacy reimbursement contracts and did not assume credit risk. Therefore, revenue was recognized as only the differential between the amount receivable from the client and the amount owed to the network pharmacy. The Company acted as an agent to its clients with respect to administrative fees for claims adjudication. Those service fees were recognized as revenue.

Gift Cards

The Company sells Walgreens gift cards to retail store customers and through its website. The Company does not charge administrative fees on unused gift cards and most gift cards do not have an expiration date. Income from gift cards is recognized when (1) the gift card is redeemed by the customer; or (2) the likelihood of the gift card being redeemed by the customer is remote ("gift card breakage") and there is no legal obligation to remit the value of unredeemed gift cards to the relevant jurisdictions. The Company's gift card breakage rate is determined based upon historical redemption patterns. Gift card breakage income, which is included in selling, general and administrative expenses, was not significant in fiscal 2011, 2010 or 2009.

Impaired Assets and Liabilities for Store Closings

The Company tests long-lived assets for impairment whenever events or circumstances indicate that a certain asset may be impaired. Store locations that have been open at least five years are reviewed for impairment indicators at least annually. Once identified, the amount of the impairment is computed by comparing the carrying value of the assets to the fair value, which is based on the discounted estimated future cash flows. Impairment charges included in selling, general and administrative expenses were $44 million in fiscal 2011, $17 million in fiscal 2010 and $10 million in fiscal 2009.

The Company also provides for future costs related to closed locations. The liability is based on the present value of future rent obligations and other related costs (net of estimated sublease rent) to the first lease option date. The reserve for store closings was $145 million, $151 million and $99 million in fiscal 2011, 2010 and 2009, respectively. See Note 3 for additional disclosure regarding the Company's reserve for future costs related to closed locations.

Insurance

The Company obtains insurance coverage for catastrophic exposures as well as those risks required by law to be insured. It is the Company's policy to retain a significant portion of certain losses related to workers' compensation, property, comprehensive general, pharmacist and vehicle liability. Liabilities for these losses are recorded based upon the Company's estimates for claims incurred and are not discounted. The provisions are estimated in part by considering historical claims experience, demographic factors and other actuarial assumptions.

Pre-Opening Expenses

Non-capital expenditures incurred prior to the opening of a new or remodeled store are expensed as incurred.

Advertising Costs

Advertising costs, which are reduced by the portion funded by vendors, are expensed as incurred. Net advertising expenses, which are included in selling, general and administrative expenses, were $271 million in fiscal 2011, $271 million in fiscal 2010 and $334 million in fiscal 2009. Included in net advertising expenses were vendor advertising allowances of $218 million in fiscal 2011, $197 million in fiscal 2010 and $174 million in fiscal 2009.

Stock-Based Compensation Plans

In accordance with ASC Topic 718, Compensation – Stock Compensation, the Company recognizes compensation expense on a straight-line basis over the employee's vesting period or to the employee's retirement eligible date, if earlier.

Total stock-based compensation expense for fiscal 2011, 2010 and 2009 was $135 million, $84 million and $84 million, respectively. The recognized tax benefit was $49 million, $29 million and $29 million for fiscal 2011, 2010 and 2009, respectively.

Unrecognized compensation cost related to non-vested awards at August 31, 2011, was $122 million. This cost is expected to be recognized over a weighted average of three years.

Income Taxes

The Company accounts for income taxes according to the asset and liability method. Under this method, deferred tax assets and liabilities are recognized based upon the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured pursuant to tax laws using rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rate is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts more likely than not to be realized.

In determining the Company's provision for income taxes, an annual effective income tax rate based on full-year income, permanent differences between book and tax income, and statutory income tax rates is used. The effective income tax rate also reflects the Company's assessment of the ultimate outcome of tax audits. Discrete events such as audit settlements or changes in tax laws are recognized in the period in which they occur.

The Company is subject to routine income tax audits that occur periodically in the normal course of business. U.S. federal, state and local and foreign tax authorities raise questions regarding the Company's tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. In evaluating the tax benefits associated with its various tax filing positions, the Company records a tax benefit for uncertain tax positions using the highest cumulative tax benefit that is more likely than not to be realized. Adjustments are made to the liability for unrecognized tax benefits in the period in which the Company determines the issue is effectively settled with the tax authorities, the statute of limitations expires for the return containing the tax position or when more information becomes available. The Company's liability for unrecognized tax benefits, including accrued penalties and interest, is included in other long-term liabilities on the Consolidated Balance Sheets and in income tax expense in the Consolidated Statements of Earnings.

Earnings Per Share
The dilutive effect of outstanding stock options on earnings per share is calculated using the treasury stock method. Stock options are anti-dilutive and excluded from the earnings per share calculation if the exercise price exceeds the average market price of the common shares. Outstanding options to purchase common shares were excluded from the earnings per share calculations because they were anti-dilutive. At August 31, 2011 and 2010, these options were 16,869,061 and 30,661,551, respectively.

Interest Expense
The Company capitalized $10 million, $12 million and $16 million of interest expense as part of significant construction projects during fiscal 2011, 2010 and 2009, respectively. Interest paid, which is net of capitalized interest, was $89 million in fiscal years 2011, 2010 and 2009.

Accumulated Other Comprehensive Income (Loss)
The Company follows ASC Topic 715, Compensation – Retirement Benefits, for treatment of its postretirement medical liability. The amount included in accumulated other comprehensive income related to the Company's postretirement plan was a gain of $4 million ($16 million after tax) at August 31, 2011, compared to a loss of $57 million ($24 million after tax) at August 31, 2010. The minimum postretirement liability totaled $407 million and $441 million at August 31, 2011 and 2010, respectively.

New Accounting Pronouncements
In August 2010, the Financial Accounting Standards Board (FASB) issued an exposure draft on lease accounting that would require entities to recognize assets and liabilities arising from lease contracts on the balance sheet. The proposed exposure draft states that lessees and lessors should apply a "right-of-use model" in accounting for all leases. Under the proposed model, lessees would recognize an asset for the right to use the leased asset, and a liability for the obligation to make rental payments over the lease term. The lease term is defined as the longest possible term that is "more likely than not" to occur. The accounting by a lessor would reflect its retained exposure to the risks or benefits of the underlying leased asset. A lessor would recognize an asset representing its right to receive lease payments based on the expected term of the lease. On the basis of feedback received from comment letters, roundtables, and outreach sessions, the FASB has made significant changes to the proposals in the exposure draft and therefore has decided to re-expose the revised exposure draft in the first quarter of 2012. The proposed standard, as currently drafted, will have a material impact on the Company's reported results of operations and financial position. The impact of this exposure draft is non-cash in nature and will not affect the Company's cash position.

On June 16, 2011, the FASB issued Accounting Standards Update (ASU) 2011-05, Presentation of Comprehensive Income. ASU 2011-05 requires entities to present the total of comprehensive income, the components of net income and the components of other comprehensive income in either (1) a single continuous statement of comprehensive income or (2) two separate but consecutive statements. The ASU does not change the items that are required to be reported in other comprehensive income. The ASU is effective for interim and annual periods beginning after December 15, 2011, and will be applied retrospectively. The Company is still evaluating which of the two alternatives it will apply in reporting comprehensive income. Neither alternative will have a material impact on the Company's results of operations or financial position.

On September 15, 2011, the FASB issued ASU 2011-08, Intangibles – Goodwill and Other, which simplifies how an entity is required to test goodwill for impairment. This ASU would allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under the ASU, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The ASU includes a number of factors to consider in conducting the qualitative assessment. The ASU is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. This standard is not expected to have a material impact on the Company's reported results of operations or financial position.

2. Restructuring

On October 30, 2008, the Company announced a series of strategic initiatives, approved by the Board of Directors, to enhance shareholder value. One of these initiatives was a program known as "Rewiring for Growth," which was designed to reduce cost and improve productivity through strategic sourcing of indirect spend, reducing corporate overhead and work throughout the Company's stores, rationalization of inventory categories, and transforming community pharmacy. These initiatives were completed in the fourth quarter of fiscal 2011.

The following pre-tax charges associated with Rewiring for Growth have been recorded in the Consolidated Statements of Earnings *(In millions)*:

	Twelve Months Ended August 31,		
	2011	2010	2009
Severance and other benefits	**$ 5**	$16	$ 74
Project cancellation settlements	**—**	—	7
Inventory charges	**—**	19	63
Restructuring expense	**5**	35	144
Consulting	**37**	50	76
Restructuring and restructuring-related costs	**$42**	$85	$220
Cost of sales	**$—**	$19	$ 63
Selling, general and administrative expenses	**42**	66	157
	$42	$85	$220

Severance and other benefits included the charges associated with employees who were separated from the Company. In the current fiscal year, 72 employees have been separated from the Company. Since inception, a total of 962 employees have been separated from the Company as a result of these initiatives.

Inventory charges relate to on-hand inventory that has been reduced from cost to selling price below cost.

The following balances have been recorded in accrued expenses and other liabilities on the Consolidated Condensed Balance Sheets *(In millions)*:

	Severance and Other Benefits
August 31, 2009 Reserve Balance	$ 4
Charges	19
Cash Payments	(23)
August 31, 2010 Reserve Balance	$—
Charges	5
Cash Payments	(5)
August 31, 2011 Reserve Balance	$—

Additionally, as a part of the Company's Customer Centric Retailing (CCR) initiative, we are modifying the store format to enhance category layouts and adjacencies, shelf heights and sight lines, and brand and private brand assortments, all of which are designed to positively impact the shopper experience and increase customer frequency and purchase size. We expect this format will be rolled out to approximately 5,500 existing stores. At August 31, 2011, in total, we have converted 5,078 stores and opened 509 new stores with the CCR format. We expect to convert the remaining existing stores in the first quarter of fiscal 2012 and continue to open new stores with the new CCR format throughout fiscal 2012. For the remaining remodels, we expect the average total cost, which

includes both selling, general and administrative expenses and capital, to be approximately $45 thousand per store. For the fiscal year ended August 31, 2011, we incurred $144 million in total program costs, of which $84 million was included in selling, general and administrative expenses and $60 million in capital costs. In fiscal 2010, we incurred $71 million in total program costs, of which $45 million was included in selling, general and administrative expenses and $26 million in capital costs. The Company incurred $5 million in program costs, all of which was included in selling, general and administrative expenses, in fiscal 2009.

3. Leases

The Company owns 21% of its operating locations; the remaining locations are leased premises. Initial terms are typically 20 to 25 years, followed by additional terms containing cancellation options at five-year intervals, and may include rent escalation clauses. The commencement date of all lease terms is the earlier of the date the Company becomes legally obligated to make rent payments or the date the Company has the right to control the property. Additionally, the Company recognizes rent expense on a straight-line basis over the term of the lease. In addition to minimum fixed rentals, most leases provide for contingent rentals based upon a portion of sales.

Minimum rental commitments at August 31, 2011, under all leases having an initial or remaining non-cancelable term of more than one year are shown below *(In millions)*:

	Capital Lease	Operating Lease
2012	9	2,381
2013	11	2,379
2014	11	2,336
2015	10	2,277
2016	10	2,215
Later	168	24,617
Total minimum lease payments	$219	$36,205

The capital lease amount includes $106 million of executory costs and imputed interest. Total minimum lease payments have not been reduced by minimum sublease rentals of approximately $18 million on leases due in the future under non-cancelable subleases.

The Company provides for future costs related to closed locations. The liability is based on the present value of future rent obligations and other related costs (net of estimated sublease rent) to the first lease option date. In fiscal 2011, 2010 and 2009, the Company recorded charges of $54 million, $90 million and $67 million, respectively, for facilities that were closed or relocated under long-term leases. These charges are reported in selling, general and administrative expenses on the Consolidated Statements of Earnings.

The changes in reserve for facility closings and related lease termination charges include the following *(In millions)*:

	Twelve Months Ended August 31,	
	2011	2010
Balance – beginning of period	**$151**	$ 99
Provision for present value of non-cancelable lease payments of closed facilities	**49**	77
Assumptions about future sublease income, terminations and changes in interest rates	**(19)**	(9)
Interest accretion	**24**	22
Cash payments, net of sublease income	**(60)**	(45)
Reserve acquired through acquisition	**—**	7
Balance – end of period	**$145**	$151

The Company remains secondarily liable on 27 assigned leases. The maximum potential undiscounted future payments are $30 million at August 31, 2011. Lease option dates vary, with some extending to 2041.

Rental expense was as follows *(In millions)*:

	2011	2010	2009
Minimum rentals	**$2,506**	$2,218	$1,973
Contingent rentals	**9**	9	11
Less: Sublease rental income	**(15)**	(9)	(9)
	$2,500	$2,218	$1,975

4. Acquisitions

In June 2011, the Company completed its acquisition of drugstore.com, inc. (drugstore.com) for cash proceeds of $398 million including the assumption of $17 million of debt. Based on preliminary purchase accounting, the acquisition added $132 million to goodwill and $122 million related to other intangible assets. The addition of drugstore.com's online business across its health, personal care, beauty and vision categories better positions the Company as the most convenient multi-channel retailer of health and daily living needs in America.

The aggregate purchase price of all business and intangible asset acquisitions excluding drugstore.com was $232 million in fiscal 2011. These acquisitions added $26 million to goodwill and $193 million to intangible assets, primarily prescription files. The remaining fair value relates to immaterial amounts of tangible assets, less liabilities assumed. Operating results of the businesses acquired have been included in the Consolidated Statements of Earnings from their respective acquisition dates forward and were not material. Pro forma results of the Company, assuming all of the acquisitions had occurred at the beginning of each period presented, would not be materially different from the results reported.

In June 2011, the Company completed the sale of its pharmacy benefit management business, Walgreens Health Initiatives, Inc. (WHI), to Catalyst Health Solutions, Inc. in a cash transaction for $525 million, $40 million of which was withheld in escrow. Net cash proceeds related to the transaction were $442 million. The Company recorded a pre-tax gain in the fourth fiscal quarter of $434 million on the transaction.

On April 9, 2010, the Company completed the stock acquisition of Duane Reade Holdings, Inc., and Duane Reade Shareholders, LLC (Duane Reade), which consisted of 258 Duane Reade stores located in the New York City metropolitan area, as well as the corporate office and two distribution centers. Total purchase price was $1,134 million, which included the assumption of debt. Included in the purchase price is a fair market value adjustment to increase debt assumed by $81 million. This acquisition increased the Company's presence in the New York metropolitan area.

The allocation of the purchase price of Duane Reade was accounted for under the purchase method of accounting in accordance with ASC Topic 805, Business Combinations. Goodwill, none of which is deductible for tax purposes, and other intangible assets recorded in connection with the acquisition totaled $401 million and $445 million, respectively. Goodwill consists of expected purchasing synergies, consolidation of operations and reductions in selling, general and administrative expenses. Intangible assets consist of $303 million of favorable lease interests (10-year weighted average useful life), $75 million in customer relationships (10-year useful life), $38 million in trade name (5-year useful life) and $29 million in other intangible assets (10-year useful life).

Assets acquired and liabilities assumed in the transaction were recorded at their acquisition date fair values while transaction costs associated with the acquisition were expensed as incurred. The Company's allocation was based on an evaluation of the appropriate fair values and represented management's best estimate based on available data. Final purchase accounting was completed in the first quarter of fiscal 2011. There were no material adjustments to the preliminary purchase price allocation.

The final fair values of assets acquired and liabilities assumed on April 9, 2010, are as follows *(In millions)*:

Accounts receivable	$ 52
Inventory	228
Other current assets	99
Property and equipment	219
Other non-current assets	3
Intangible assets	445
Goodwill	401
Total assets acquired	1,447
Liabilities assumed	313
Debt assumed	574
Net cash paid	$ 560

The fair values of goodwill and intangible assets associated with the acquisition of Duane Reade were determined to be Level 3 measurements under the fair value hierarchy. Intangible asset values were estimated based on future cash flows and customer attrition rates discounted using an estimated weighted average cost of capital.

The Company assumed federal net operating losses of $286 million and state net operating losses of $261 million, both of which begin to expire in 2018, in conjunction with the Duane Reade acquisition.

In fiscal 2011 and 2010, the Company incurred $32 million and $71 million, respectively, in costs related to the acquisition, all of which was included in selling, general and administrative expenses. Actual results from Duane Reade operations included in the Consolidated Statements of Earnings since the date of acquisition are as follows *(In millions, except per share amounts)*:

	Twelve Months Ended August,	
	2011	2010
Net sales	**$1,868**	$ 732
Net loss	**(7)**	(56)
Net earnings per common share:		
Basic	**(0.01)**	(0.06)
Diluted	**(0.01)**	(0.06)

5. Goodwill and Other Intangible Assets

Goodwill and other indefinite-lived intangible assets are not amortized, but are evaluated for impairment annually during the fourth quarter, or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. As part of the Company's impairment analysis for each reporting unit, the Company engaged a third party appraisal firm to assist in the determination of estimated fair value for each unit. This determination included estimating the fair value using both the income and market approaches. The income approach requires management to estimate a number of factors for each reporting unit, including projected future operating results, economic projections, anticipated future cash flows and discount rates. The market approach estimates fair value using comparable marketplace fair value data from within a comparable industry grouping.

The determination of the fair value of the reporting units and the allocation of that value to individual assets and liabilities within those reporting units requires the Company to make significant estimates and assumptions. These estimates and assumptions primarily include, but are not limited to: the selection of appropriate peer group companies; control premiums appropriate for acquisitions in the industries in which the Company competes; the discount rate; terminal growth rates; and forecasts of revenue, operating income, depreciation and amortization and capital expenditures. The allocation requires several analyses to determine fair value of assets and liabilities including, among other things, purchased prescription files, customer relationships and trade names. Although the Company believes its estimates of fair value are reasonable, actual financial results could differ from those estimates due to the inherent uncertainty involved in making such estimates. Changes in assumptions concerning future financial results or other underlying assumptions could have a significant impact on either the fair value of the reporting units, the amount of the goodwill impairment charge, or both. The Company also compared the sum of the estimated fair values of its reporting units to the total value as implied by the market value of its equity and debt securities. This comparison indicated that, in total, its assumptions and estimates were reasonable. However, future declines in the overall market value of the Company's equity and debt securities may indicate that the fair value of one or more reporting units has declined below its carrying value.

One measure of the sensitivity of the amount of goodwill impairment charges to key assumptions is the amount by which each reporting unit "passed" (fair value exceeds the carrying amount) or "failed" (the carrying amount exceeds fair value) the first step of the goodwill impairment test. The Company's reporting units' fair values exceeded their carrying amounts by 5% to more than 300%. The fair values for two reporting units each exceeded their carrying amounts by 10% or less. Goodwill allocated to these reporting units was $173 million at May 31, 2011. For each of these reporting units, relatively small changes in the Company's key assumptions may have resulted in the recognition of significant goodwill impairment charges. The Company's Long Term Care Pharmacy's goodwill was impaired by $16 million in fiscal 2010 as a result of the asset sale agreement with Omnicare, Inc., which was signed on August 31, 2010.

Generally, changes in estimates of expected future cash flows would have a similar effect on the estimated fair value of the reporting unit. That is, a 1% change in estimated future cash flows would decrease the estimated fair value of the reporting unit by approximately 1%. The estimated long-term rate of net sales growth can have a significant impact on the estimated future cash flows, and therefore, the fair value of each reporting unit. For the two reporting units whose fair values exceeded carrying values by 10% or less, a 1% decrease in the long-term net sales growth rate would have resulted in the reporting units failing the first step of the goodwill impairment test. Of the other key assumptions that impact the estimated fair values, most reporting units have the greatest sensitivity to changes in the estimated discount rate. A 1% increase in estimated discount rates for the two reporting units whose fair value exceeded carrying value by 10% or less would also have resulted in the reporting units failing step one. The Company believes that its estimates of future cash flows and discount rates are reasonable, but future changes in the underlying assumptions could differ due to the inherent uncertainty in making such estimates.

Changes in the carrying amount of goodwill consist of the following activity *(In millions)*:

	2011	2010
Net book value – September 1		
Goodwill	**$ 1,915**	$1,473
Accumulated impairment losses	**(28)**	(12)
Total	**1,887**	1,461
Acquisitions	**158**	442
Impairment charges	**—**	(16)
Other	**(28)**	—
Net book value – August 31	**$ 2,017**	$1,887

The carrying amount and accumulated amortization of intangible assets consists of the following *(In millions)*:

	2011	2010
Gross Intangible Assets		
Purchased prescription files	**$ 913**	$ 749
Favorable lease interests	**385**	377
Purchasing and payer contracts	**308**	280
Non-compete agreements	**95**	69
Trade name	**71**	44
Other amortizable intangible assets	**4**	34
Total gross intangible assets	**1,776**	1,553
Accumulated amortization		
Purchased prescription files	**(338)**	(293)
Favorable lease interests	**(76)**	(38)
Purchasing and payer contracts	**(94)**	(68)
Non-compete agreements	**(43)**	(33)
Trade name	**(11)**	(3)
Other amortizable intangibles	**(2)**	(4)
Total accumulated amortization	**(564)**	(439)
Total intangible assets, net	**$1,212**	$1,114

Amortization expense for intangible assets was $219 million in fiscal 2011, $182 million in fiscal 2010 and $148 million in fiscal 2009. The weighted-average amortization period for purchased prescription files was seven years for fiscal 2011 and six years fiscal 2010. The weighted-average amortization period for favorable lease interests was 11 years for fiscal 2011 and 2010. The weighted-average amortization period for purchasing and payer contracts was 13 years for fiscal 2011 and 2010. The weighted-average amortization period for non-compete agreements was five years for fiscal 2011 and 2010. The weighted-average amortization period for trade names was nine years for fiscal 2011 and five years for fiscal 2010. Trade names include $6 million of indefinite life assets. The weighted-average amortization period for other intangible assets was 10 years for fiscal 2011 and 2010.

Expected amortization expense for intangible assets recorded at August 31, 2011, is as follows *(In millions)*:

2012	2013	2014	2015	2016
$218	$192	$160	$128	$90

6. Income Taxes

The provision for income taxes consists of the following *(In millions)*:

	2011	2010	2009
Current provision –			
Federal	**$1,301**	$1,129	$ 807
State	**147**	90	91
	1,448	1,219	898
Deferred provision –			
Federal	**113**	62	243
State	**19**	1	17
	132	63	260
Income tax provision	**$1,580**	$1,282	$1,158

The difference between the statutory federal income tax rate and the effective tax rate is as follows:

	2011	2010	2009
Federal statutory rate	**35.0%**	35.0%	35.0%
State income taxes, net of federal benefit	**2.6**	2.2	2.2
Medicare Part D Subsidy	**—**	1.3	—
Other	**(0.8)**	(0.5)	(0.6)
Effective income tax rate	**36.8%**	38.0%	36.6%

The deferred tax assets and liabilities included in the Consolidated Balance Sheets consist of the following *(In millions)*:

	2011	2010
Deferred tax assets –		
Postretirement benefits	**$ 214**	$ 179
Compensation and benefits	**165**	228
Insurance	**226**	190
Accrued rent	**112**	176
Tax benefits	**327**	138
Stock compensation	**179**	133
Inventory	**143**	59
Other	**78**	123
Subtotal	**1,444**	1,226
Less: Valuation allowance	**91**	—
Total deferred tax assets	**1,353**	1,226
Deferred tax liabilities –		
Accelerated depreciation	**1,176**	1,050
Inventory	**476**	356
Intangible assets	**49**	117
Other	**31**	45
Subtotal	**1,732**	1,568
Net deferred tax liabilities	**$ 379**	$ 342

At August 31, 2011, the Company has recorded deferred tax assets of $287 million reflecting the benefit of $452 million in federal and $940 million in state loss carryforwards. These deferred tax assets will expire at various dates from 2012 through 2031.

The Company believes it is more likely than not that the benefit from certain net operating loss carryforwards will not be realized. In recognition of this risk, the Company has recorded a valuation allowance of $91 million on certain deferred tax assets relating to these net operating losses.

Income taxes paid were $1,320 million, $1,195 million and $768 million during the fiscal years ended August 31, 2011, 2010 and 2009, respectively.

ASC Topic 740, Income Taxes, provides guidance regarding the recognition, measurement, presentation and disclosure in the financial statements of tax positions taken or expected to be taken on a tax return, including the decision whether to file in a particular jurisdiction. All unrecognized benefits at August 31, 2011, and August 31, 2010, were classified as long-term liabilities on the Consolidated Balance Sheets.

The following table provides a reconciliation of the total amounts of unrecognized tax benefits for fiscal 2011 *(In millions)*:

	2011	2010	2009
Balance at beginning of year	**$93**	$128	$ 64
Gross increases related to tax positions in a prior period	**25**	12	38
Gross decreases related to tax positions in a prior period	**(68)**	(57)	(5)
Gross increases related to tax positions in the current period	**54**	37	38
Settlements with taxing authorities	**(8)**	(21)	(1)
Lapse of statute of limitations	**(2)**	(6)	(6)
Balance at end of year	**$94**	$ 93	$128

At August 31, 2011, 2010 and 2009, $81 million, $57 million and $43 million, respectively, of unrecognized tax benefits would favorably impact the effective tax rate if recognized.

The Company recognizes interest and penalties in the income tax provision in its Consolidated Statements of Earnings. At August 31, 2011, and August 31, 2010, the Company had accrued interest and penalties of $24 million and $20 million, respectively.

The Company files a consolidated U.S. federal income tax return, as well as income tax returns in various states. It is no longer subject to U.S. federal income tax examinations for years before fiscal 2008, except for one issue related to fiscal 2006 and 2007 currently in appeals. With few exceptions, it is no longer subject to state and local income tax examinations by tax authorities for years before fiscal 2006. The Company anticipates that the Internal Revenue Service will complete its audit of fiscal years 2008 and 2009 in fiscal 2012.

It is reasonably possible that the amount of the unrecognized tax benefit with respect to certain unrecognized tax positions will increase or decrease during the next 12 months; however, the Company does not expect the change to have a material effect on its results of operations or its financial position.

7. Short-Term Borrowings and Long-Term Debt

Short-term borrowings and long-term debt consists of the following at August 31 *(In millions)*:

	2011	2010
Short-Term Borrowings –		
Current maturities of loans assumed through the purchase of land and buildings; various interest rates from 5.00% to 8.75%; various maturities from 2012 to 2035	**$ 8**	$ 7
Other	**5**	5
Total short-term borrowings	**$ 13**	$ 12
Long-Term Debt –		
4.875% unsecured notes due 2013 net of unamortized discount and interest rate swap fair market value adjustment (see Note 8)	**$1,339**	$1,348
5.250% unsecured notes due 2019 net of unamortized discount and interest rate swap fair market value adjustment (see Note 8)	**1,011**	995
Loans assumed through the purchase of land and buildings; various interest rates from 5.00% to 8.75%; various maturities from 2012 to 2035	**54**	53
	2,404	2,396
Less current maturities	**(8)**	(7)
Total long-term debt	**$2,396**	$2,389

The Company has had no activity or outstanding balances in its commercial paper program since the second quarter of fiscal 2009. In connection with the commercial paper program, the Company maintains two unsecured backup syndicated lines of credit that total $1.1 billion. The first $500 million facility expires on July 20, 2015, and allows for the issuance of up to $250 million in letters of credit, which reduces the amount available for borrowing. The second $600 million facility expires on August 13, 2012. The Company's ability to access these facilities is subject to compliance with the terms and conditions of the credit facilities, including financial covenants. The covenants require the Company to maintain certain financial ratios related to minimum net worth and priority debt, along with limitations on the sale of assets and purchases of investments. At August 31, 2011, the Company was in compliance with all such covenants. The Company pays a facility fee to the financing banks to keep these lines of credit active. At August 31, 2011, there were no letters of credit issued against these credit facilities and the Company does not anticipate any future letters of credit to be issued against these facilities.

On July 17, 2008, the Company issued notes totaling $1,300 million bearing an interest rate of 4.875% paid semiannually in arrears on February 1 and August 1 of each year, beginning on February 1, 2009. The notes will mature on August 1, 2013. The Company may redeem the notes, at any time in whole or from time to time in part, at its option at a redemption price equal to the greater of: (1) 100% of the principal amount of the notes to be redeemed; or (2) the sum of the present values of the remaining scheduled payments of principal and interest, discounted to the date of redemption on a semiannual basis at the Treasury Rate, plus 30 basis points, plus accrued interest on the notes to be redeemed to, but excluding, the date of redemption. If a change of control triggering event occurs, unless the Company has exercised its option to redeem the notes, it will be required to offer to repurchase the notes at a purchase price equal to 101% of the principal amount of the notes plus accrued and unpaid interest to the date of redemption. The notes are unsecured senior debt obligations and rank equally with all other unsecured senior indebtedness of the Company. The notes are not convertible or exchangeable. Total issuance costs relating to this offering were $9 million, which included $8 million in underwriting fees. The fair value of the notes as of August 31, 2011 and 2010, was $1,403 million and $1,446 million, respectively. Fair value for these notes was determined based upon quoted market prices.

On January 13, 2009, the Company issued notes totaling $1,000 million bearing an interest rate of 5.25% paid semiannually in arrears on January 15 and July 15 of each year, beginning on July 15, 2009. The notes will mature on January 15, 2019. The Company may redeem the notes, at any time in whole or from time to time in part, at its option at a redemption price equal to the greater of: (1) 100% of the principal amount of the notes to be redeemed; or (2) the sum of the present values of the remaining scheduled payments of principal and interest, discounted to the date of redemption on a semiannual basis at the Treasury Rate, plus 45 basis points, plus accrued interest on the notes to be redeemed to, but excluding, the date of redemption. If a change of control triggering event occurs, unless the Company has exercised its option to redeem the notes, it will be required to offer to repurchase the notes at a purchase price equal to 101% of the principal amount of the notes plus accrued and unpaid interest to the date of redemption. The notes are unsecured senior debt obligations and rank equally with all other unsecured senior indebtedness of the Company. The notes are not convertible or exchangeable. Total issuance costs relating to this offering were $8 million, which included $7 million in underwriting fees. The fair value of the notes as of August 31, 2011 and 2010 was $1,173 million and $1,167 million, respectively. Fair value for these notes was determined based upon quoted market prices.

8. Financial Instruments

The Company uses derivative instruments to manage its interest rate exposure associated with some of its fixed-rate borrowings. The Company does not use derivative instruments for trading or speculative purposes. All derivative instruments are recognized in the Consolidated Balance Sheets at fair value. The Company designates interest rate swaps as fair value hedges of fixed-rate borrowings. For derivatives designated as fair value hedges, the change in the fair value of both the derivative instrument and the hedged item are recognized in earnings in the current period. At the inception of a hedge transaction, the Company formally documents the hedge relationship and the risk management objective for undertaking the hedge. In addition, it assesses both at inception of the hedge and on an ongoing basis whether the derivative in the hedging transaction has been highly effective in offsetting changes in fair value of the hedged item and whether the derivative is expected to continue to be highly effective. The impact of any ineffectiveness is recognized currently in earnings.

Counterparties to derivative financial instruments expose the Company to credit-related losses in the event of nonperformance, but the Company regularly monitors the creditworthiness of each counterparty.

Fair Value Hedges

For derivative instruments that are designated and qualify as fair value hedges, the gain or loss on the derivative, as well as the offsetting gain or loss on the hedged item attributable to the hedged risk, are recognized in interest expense on the Consolidated Statement of Earnings.

In January 2010, the Company terminated its existing one-month future LIBOR swaps that converted $1,300 million of its 4.75% fixed rate debt to floating. Upon termination, the Company received payment from its counterparty that consisted of accrued interest and an amount representing the fair value of the swaps. The related fair value benefit attributed to the Company's debt continues to amortize over the life of the debt, which matures on August 1, 2013. The Company then entered into six-month LIBOR in arrears swaps with two counterparties.

In May 2011, the Company entered into interest rate swaps with two counterparties converting $250 million of its 5.25% fixed rate notes to a floating interest rate based on the six-month LIBOR in arrears plus a constant spread. The swap termination date coincides with the notes maturity date, January 15, 2019.

The notional amounts of derivative instruments outstanding at August 31, 2011 and 2010, were as follows *(In millions)*:

	2011	2010
Derivatives designated as hedges:		
Interest rate swaps	**$1,550**	$1,300

The changes in fair value of the notes attributable to the hedged risk are included in long-term debt on the Consolidated Balance Sheets (see Note 7) and amortized through maturity. At August 31, 2011 and 2010, the Company had net unamortized fair value changes of $57 million and $51 million, respectively.

The fair value and balance sheet presentation of derivative instruments at August 31, 2011, were as follows *(In millions)*:

	Location in Consolidated Balance Sheet	**2011**	2010
Asset derivatives designated as hedges:			
Interest rate swaps	Other non-current assets	**$63**	$44

Gains and losses relating to the ineffectiveness of the Company's derivative instruments are recorded in interest expense on the Consolidated Statement of Earnings. The Company recorded a $1 million gain in both fiscal years 2011 and 2010.

9. Fair Value Measurements

The Company measures its assets and liabilities in accordance with ASC Topic 820, Fair Value Measurements and Disclosures. ASC Topic 820 defines fair value as the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. In addition, it establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels:

Level 1 – Quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2 – Observable inputs other than quoted prices in active markets.

Level 3 – Unobservable inputs for which there is little or no market data available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

Assets and liabilities measured at fair value on a recurring basis were as follows *(In millions)*:

	August 31, 2011	Level 1	Level 2	Level 3
Assets:				
Money market funds	$1,239	$1,239	$ —	$ —
Interest rate swaps	63	—	63	—
	August 31, 2010	Level 1	Level 2	Level 3
Assets:				
Money market funds	$1,030	$1,030	$ —	$ —
Interest rate swaps	44	—	44	—

Interest rate swaps are valued using six-month LIBOR in arrears rates. See Note 8 for additional disclosure regarding financial instruments.

Assets measured at fair value on a non-recurring basis were as follows *(In millions)*:

	August 31, 2010	Level 1	Level 2	Level 3
Assets:				
Goodwill	$3	—	—	$3

Goodwill for the Company's Long-Term Care Pharmacy with a carrying value of $19 million was written down to its implied fair value of $3 million in fiscal year 2010. The impairment resulted in a $16 million charge and added a $6 million deferred tax asset. The determination of fair value was based on an asset sale agreement with Omnicare, Inc., which was signed on August 31, 2010. See Note 5 for further discussion on the impairment.

The Company reports its debt instruments under the guidance of ASC Topic 825, Financial Instruments, which requires disclosure of the fair value of the Company's debt in the footnotes to the consolidated condensed financial statements.

10. Commitments and Contingencies

The Company is involved in legal proceedings, including those described below, and is subject to investigations, inspections, audits, inquiries and similar actions by governmental authorities, arising in the normal course of the Company's business. Litigation, in general, and securities and class action litigation, in particular, can be expensive and disruptive. Some of these suits may purport or may be determined to be class actions and/or involve parties seeking large and/or indeterminate amounts, including punitive or exemplary damages, and may remain unresolved for several years. The results of legal proceedings are often uncertain and difficult to predict, and the costs incurred in litigation can be substantial, regardless of the outcome.

On a quarterly basis, the Company assesses its liabilities and contingencies for outstanding legal proceedings, including those described below, and reserves are established on a case-by-case basis for those legal claims for which management concludes that it is probable that a loss will be incurred and that the amount of such loss can be reasonably estimated. Management's assessment of our current litigation and other legal proceedings, including the corresponding accruals, could change because of the discovery of facts with respect to legal actions or other proceedings pending against the Company which are not presently known. Adverse determinations by judges, juries or other parties could also result in changes to management's assessment of current liabilities and contingencies. The ultimate costs of resolving these claims may be substantially higher or lower than the amounts reserved. Due to the inherent difficulty of predicting the outcome of litigation and other legal proceedings, the Company cannot predict the eventual outcome of these matters, and it is reasonably possible that some of them could be resolved unfavorably to the Company. As a result, it is possible that the Company's results of operations or cash flows in a particular fiscal period could be materially affected by an unfavorable resolution of pending litigation or contingencies. However, based on its current

knowledge, management does not expect reasonably possible losses relating to the outcome of current litigation and legal proceedings, after consideration of applicable reserves and rights to indemnification, to be material to the Company's consolidated financial position.

On August 31, 2009, a Walgreen Co. shareholder named Dan Himmel filed a lawsuit, purportedly on the Company's behalf, against several current and former officers and directors (each, an "Individual Defendant"). The case was captioned *Himmel v. Wasson, et. al.* and was filed in the Circuit Court of Lake County, Illinois. Himmel alleged that the Company's management: (i) knew, or was reckless in not knowing, that selling, general and administrative expenses in the fourth quarter of 2007 were too high, in light of decreased profits from generic drug sales; (ii) knew, or was reckless in not knowing, that the Company would not realize gross profits near what many Wall Street analysts were predicting; and (iii) the directors and officers had a duty both to prevent the drop in gross profits and to disclose the expected drop to the public and failed to do either. On September 28, 2011, the Circuit Court approved a settlement agreement among the parties pursuant to which the Company agreed to pay an amount in respect of plaintiff's attorneys' fees and litigation expenses and the Circuit Court dismissed the case with prejudice. The settlement was not material to the Company's business or consolidated financial position.

The Company previously guaranteed a credit agreement on behalf of SureScripts-RxHub, LLC, which provides electronic prescription data services. The guarantee arose as a result of a business decision between parties to ensure that the operations of SureScripts-RxHub, LLC would have additional support to access financing. The liability was $10 million at August 31, 2010. In the third quarter of the current fiscal year, the Company was fully released from its guarantee obligation.

11. Capital Stock

On October 14, 2009, the Board of Directors approved a long-term capital policy to maintain a strong balance sheet and financial flexibility; reinvest in its core strategies; invest in strategic opportunities that reinforce its core strategies and meet return requirements; and return surplus cash flow to shareholders in the form of dividends and share repurchases over the long term. In connection with the Company's capital policy, its Board of Directors authorized a share repurchase program (2009 repurchase program) and set a long-term dividend payout ratio target between 30 and 35 percent of net income. The 2009 repurchase program, which was completed in September 2010, allowed for the repurchase of up to $2.0 billion of the Company's common stock. Shares totaling $360 million and $1,640 million were purchased in conjunction with the 2009 repurchase program during fiscal 2011 and 2010, respectively. On October 13, 2010, the Board of Directors authorized the 2011 repurchase program, which was completed in July 2011, which allowed for the repurchase of up to $1.0 billion of the Company's common stock. On July 13, 2011, the Board of Directors authorized the 2012 repurchase program, which allows for the repurchase of up to $2.0 billion of the Company's common stock prior to its expiration on December 31, 2015. Shares totaling $424 million were purchased in fiscal 2011 related to the 2012 program. In addition, the Company continues to repurchase shares to support the needs of the employee stock plans. Shares totaling $244 million were purchased to support the needs of the employee stock plans during the current fiscal year as compared to $116 million last year. At August 31, 2011, 65,846,553 shares of common stock were reserved for future issuances under the Company's various employee benefit plans. The timing and amount of repurchases is based on an assessment of various factors including prevailing market conditions, alternate uses of capital, liquidity, the economic environment and other factors. The Company has, and may from time to time in the future, repurchase shares on the open market through Rule 10b5-1 plans, which enable a company to repurchase shares at times when it otherwise might be precluded from doing so under insider trading laws.

12. Stock Compensation Plans

The Walgreen Co. Stock Purchase/Option Plan (Share Walgreens) provides for the granting of options to purchase common stock over a 10-year period to eligible non-executive employees upon the purchase of Company shares, subject to certain restrictions. Employees may purchase Company shares through cash purchases or loans. The option price is the closing price of a share of common stock on the grant date. Options may be granted under this Plan until September 30, 2012, for an aggregate of 42,000,000 shares of common stock. At August 31, 2011, there were 13,166,886 shares available for future grants. The options granted during fiscal 2011, 2010 and 2009 have a three-year vesting period.

The Walgreen Co. Executive Stock Option Plan provides for the granting of options to eligible key employees to purchase common stock over a 10-year period, at a price not less than the fair market value on the date of the grant. Under this Plan, options may be granted until January 13, 2020, for an aggregate of 63,400,000 shares of common stock. At August 31, 2011, 20,663,973 shares were available for future grants. The options granted during fiscal 2011, 2010 and 2009 have a three-year vesting period.

The Walgreen Co. Broad Based Employee Stock Option Plan provides for the granting of options to eligible non-executive employees to purchase common stock over a ten-year period, at a price not less than the fair market value on the date of the grant. Under this Plan, on March 11, 2003, substantially all non-executive employees, in conjunction with the opening of the Company's 4,000th store, were granted a stock option to purchase 100 shares. The Plan authorized the grant of an aggregate of 15,000,000 shares of common stock. At August 31, 2011, 7,833,423 shares were available for future grants. The options vested and became exercisable on March 11, 2006, and any unexercised options will expire on March 10, 2013, subject to earlier termination if the optionee's employment ends.

The Walgreen Co. 1982 Employees Stock Purchase Plan permits eligible employees to purchase common stock at 90% of the fair market value at the date of purchase. Employees may make purchases by cash, loans or payroll deductions up to certain limits. The aggregate number of shares that may be purchased under this Plan is 94,000,000. At August 31, 2011, 18,500,086 shares were available for future purchase.

The Walgreen Co. Long-Term Performance Incentive Plan (amended and restated Restricted Performance Share Plan) was approved by the shareholders on January 10, 2007. The Plan offers performance-based incentive awards and equity-based awards to key employees. The awards are subject to restrictions as to continuous employment except in the case of death, normal retirement or total and permanent disability. Restrictions generally lapse over a multiyear period from the date of grant. The Long-Term Performance Incentive Plan was authorized to grant an aggregate of 10,000,000 shares of common stock. As of August 31, 2011, 5,682,185 shares were available for future issuance under the Long-Term Performance Incentive Plan. In accordance with ASC Topic 718, Compensation – Stock Compensation, compensation expense is recognized on a straight-line basis over the employee's vesting period or to the employee's retirement eligible date, if earlier. Compensation expense related to the Plan was $1 million in fiscal 2011. This compares to $3 million in fiscal 2010 and $6 million in fiscal 2009.

In fiscal 2009, the Company introduced the Restricted Stock Unit and Performance Share Plans under the Long-Term Performance Incentive Plan. In accordance with ASC Topic 718, Compensation – Stock Compensation, compensation expense is recognized on a straight-line basis based on a three-year cliff vesting schedule for the annual restricted stock units and straight line over a three-year vesting schedule for the performance shares. The Company recognized $45 million, $18 million and $12 million of expense related to these plans in fiscal years 2011, 2010 and 2009, respectively.

The Walgreen Co. Nonemployee Director Stock Plan provides that each nonemployee director receives an equity grant of shares each year on November 1. Effective November 1, 2009, the value of the annual stock grant made to directors on each November 1 increased from $120,000 to $155,000. The number of shares granted is determined by dividing $155,000 by the price of a share of common stock on November 1. Each nonemployee director may elect to receive this annual share grant in the form of shares or deferred stock units. Each nonemployee director received a grant of 4,552 shares in fiscal 2011, 4,097 shares in fiscal 2010 and 4,713 shares in fiscal 2009. New directors in any of the fiscal years were given a prorated amount. Effective November 1, 2009, the payment of the annual retainer was changed to be paid only in the form of cash, which may still be deferred. Previously, the annual retainer was paid one-half in cash and one-half in Walgreen Co. common stock.

A summary of information relative to the Company's stock option plans follows:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term *(Years)*	Aggregate Intrinsic Value *(In millions)*
Outstanding at August 31, 2010	49,107,203	34.75	6.03	$ 16
Granted	**9,015,933**	**28.93**		
Exercised	**(4,349,340)**	**33.74**		
Expired/Forfeited	**(4,739,950)**	**35.44**		
Outstanding at August 31, 2011	**49,033,846**	**33.70**	**6.04**	**193**
Vested or expected to vest at August 31, 2011	**28,919,936**	**29.89**	**7.75**	**164**
Exercisable at August 31, 2011	**19,154,555**	**39.63**	**3.32**	**$ 24**

The intrinsic value for options exercised in fiscal 2011, 2010 and 2009 was $33 million, $29 million and $6 million, respectively. The total fair value of options vested in fiscal 2011, 2010 and 2009 was $58 million, $53 million and $56 million, respectively.

Cash received from the exercise of options in fiscal 2011 was $147 million compared to $134 million in the prior year. The related tax benefit realized was $14 million in fiscal 2011 compared to $11 million in the prior year.

A summary of information relative to the Company's restricted stock awards follows:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at August 31, 2010	96,710	$37.53
Granted	**—**	**—**
Forfeited	**(111)**	**36.43**
Vested	**(48,553)**	**38.92**
Nonvested at August 31, 2011	**48,046**	**$36.13**

A summary of information relative to the Company's restricted stock unit plan follows:

Outstanding Shares	Shares	Weighted-Average Grant-Date Fair Value
Outstanding at August 31, 2010	1,148,164	$34.40
Granted	**1,005,255**	**33.13**
Dividends	**37,510**	**38.16**
Forfeited	**(191,137)**	**33.31**
Vested	**(88,555)**	**32.76**
Outstanding at August 31, 2011	**1,911,237**	**$33.94**

A summary of information relative to the Company's performance share plan follows:

Outstanding Shares	Shares	Weighted-Average Grant-Date Fair Value
Outstanding at August 31, 2010	996,621	$ 35.02
Granted	**840,101**	**28.30**
Forfeited	**(17,054)**	**29.21**
Vested	**—**	**—**
Outstanding at August 31, 2011	**1,819,668**	**$ 31.83**

The fair value of each option grant was determined using the Black-Scholes option pricing model with weighted-average assumptions used in fiscal 2011, 2010 and 2009:

	2011	2010	2009
Risk-free interest rate *(1)*	**2.12%**	3.14%	3.47%
Average life of option (years) *(2)*	**7.2**	7.3	6.8
Volatility *(3)*	**28.08%**	28.01%	34.00%
Dividend yield *(4)*	**1.94%**	1.91%	2.30%
Weighted-average grant-date fair value Granted at market price	**$8.12**	$9.80	$9.14

(1) Represents the U.S. Treasury security rates for the expected term of the option.

(2) Represents the period of time that options granted are expected to be outstanding. The Company analyzed separate groups of employees with similar exercise behavior to determine the expected term.

(3) Volatility was based on historical and implied volatility of the Company's common stock.

(4) Represents the Company's cash dividend for the expected term.

13. Retirement Benefits

The principal retirement plan for employees is the Walgreen Profit-Sharing Retirement Trust, to which both the Company and participating employees contribute. The Company's contribution, which has historically related to pre-tax income and a portion of which is in the form of a guaranteed match, is determined annually at the discretion of the Board of Directors. The profit-sharing provision was $382 million in fiscal 2011, $300 million in fiscal 2010 and $282 million in fiscal 2009. The Company's contributions were $322 million in fiscal 2011, $293 million in fiscal 2010 and $301 million in fiscal 2009.

The Company provides certain health insurance benefits for retired employees who meet eligibility requirements, including age, years of service and date of hire. The costs of these benefits are accrued over the service life of the employee. The postretirement health benefit plans are not funded. In May 2009, the postretirement health benefit plans were amended to change eligibility requirements. As a result of this amendment, the Company recognized curtailment income of $16 million in fiscal 2009. Additionally in fiscal 2009, the Company recognized a special retirement benefit expense of $4 million related to accelerating eligibility for certain employees who elected special early retirement as a part of its Rewiring for Growth program.

Components of net periodic benefit costs *(In millions)*:

	2011	2010	2009
Service cost	**$15**	$11	$12
Interest cost	**22**	20	26
Amortization of actuarial loss	**14**	7	4
Amortization of prior service cost	**(10)**	(10)	(6)
Special retirement benefit	**—**	—	4
Curtailment gain	**—**	—	(16)
Total postretirement benefit cost	**$41**	$28	$24

Change in benefit obligation *(In millions)*:

	2011	2010
Benefit obligation at September 1	**$441**	$328
Service cost	**15**	11
Interest cost	**22**	20
Actuarial (gain) loss	**(57)**	92
Benefit payments	**(18)**	(14)
Participants' contributions	**4**	4
Benefit obligation at August 31	**$407**	$441

Change in plan assets *(In millions)*:

	2011	2010
Plan assets at fair value at September 1	**$ —**	$ —
Plan participants' contributions	**4**	4
Employer contributions	**14**	10
Benefits paid	**(18)**	(14)
Plan assets at fair value at August 31	**$ —**	$ —

Funded status *(In millions)*:

	2011	2010
Funded status	**$(407)**	$(441)
Unrecognized actuarial gain	**—**	—
Unrecognized prior service cost	**—**	—
Accrued benefit cost at August 31	**$(407)**	$(441)

Amounts recognized in the Consolidated Balance Sheets *(In millions)*:

	2011	2010
Current liabilities (present value of expected 2012 net benefit payments)	**$ (11)**	$ (11)
Non-current liabilities	**(396)**	(430)
Net liability recognized at August 31	**$(407)**	$(441)

Amounts recognized in accumulated other comprehensive (income) loss *(In millions)*:

	2011	2010
Prior service credit	**$(121)**	$(131)
Net actuarial loss	**117**	188

Amounts expected to be recognized as components of net periodic costs for fiscal year 2012 *(In millions)*:

	2012
Prior service credit	$ (10)
Net actuarial loss	8

The measurement date used to determine postretirement benefits is August 31.

The discount rate assumption used to compute the postretirement benefit obligation at year-end was 5.40% for 2011 and 4.95% for 2010. The discount rate assumption used to determine net periodic benefit cost was 4.95%, 6.15% and 7.50% for fiscal years ending 2011, 2010 and 2009, respectively. The consumer price index assumption used to compute the postretirement benefit obligation was 2.00% for 2011 and 3.50% for 2010.

Future benefit costs were estimated assuming medical costs would increase at a 7.50% annual rate, gradually decreasing to 5.25% over the next nine years and then remaining at a 5.25% annual growth rate thereafter. A one percentage point change in the assumed medical cost trend rate would have the following effects *(In millions)*:

	1% Increase	1% Decrease
Effect on service and interest cost	$ 7	$ (6)
Effect on postretirement obligation	73	(59)

Estimated future benefit payments and federal subsidy *(In millions)*:

	Estimated Future Benefit Payments	Estimated Federal Subsidy
2012	$ 13	$ 1
2013	14	2
2014	15	2
2015	17	2
2016	19	3
2017–2021	133	21

The expected benefit to be paid net of the estimated federal subsidy during fiscal year 2012 is $12 million.

14. Supplementary Financial Information

Non-cash transactions in fiscal 2011 include $116 million in accrued liabilities related to the purchase of property and equipment, a $62 million increase in the retiree medical benefit liability and a $36 million increase in the liability for dividends declared. Non-cash transactions in fiscal 2010 include a $95 million increase in the retiree medical benefit liability, a $29 million increase in the liability for dividends declared and $44 million in accrued liabilities related to the purchase of property and equipment.

Included in the Consolidated Balance Sheets captions are the following assets and liabilities *(In millions)*:

	2011	2010
Accounts receivable –		
Accounts receivable	**$2,598**	$2,554
Allowance for doubtful accounts	**(101)**	(104)
	$2,497	$2,450
Other non-current assets –		
Intangible assets, net (see Note 5)	**$1,212**	$1,114
Other	**377**	168
	$1,589	$1,282
Accrued expenses and other liabilities –		
Accrued salaries	**$ 856**	$ 781
Taxes other than income taxes	**489**	419
Insurance	**230**	233
Profit sharing	**253**	197
Other	**1,247**	1,133
	$3,075	$2,763
Other non-current liabilities –		
Postretirement health care benefits	**$ 396**	$ 430
Accrued rent	**418**	384
Insurance	**346**	330
Other	**625**	591
	$1,785	$1,735

Summary of Quarterly Results *(Unaudited)*

(In millions, except per share amounts)

		Quarter Ended				
		November	February	May	August	Fiscal Year
Fiscal 2011	Net Sales	**$17,344**	**$18,502**	**$18,371**	**$17,967**	**$72,184**
	Gross Profit	**4,945**	**5,324**	**5,154**	**5,069**	**20,492**
	Net Earnings	**580**	**739**	**603**	**792**	**2,714**
	Per Common Share – Basic	**$ .62**	**$ .80**	**$ .66**	**$ .88**	**$ 2.97**
	– Diluted	**.62**	**.80**	**.65**	**.87**	**2.94**
	Cash Dividends Declared Per Common Share	**$ .1750**	**$ .1750**	**$ .1750**	**$ .2250**	**$ .7500**
Fiscal 2010	Net Sales	$16,364	$16,987	$17,199	$16,870	$67,420
	Gross Profit	4,538	4,897	4,749	4,792	18,976
	Net Earnings	489	669	463	470	2,091
	Per Common Share – Basic	$ .49	$ .68	$ .47	$ .49	$ 2.13
	– Diluted	.49	.68	.47	.49	2.12
	Cash Dividends Declared Per Common Share	$ .1375	$ .1375	$ .1375	$ .1750	$ .5875

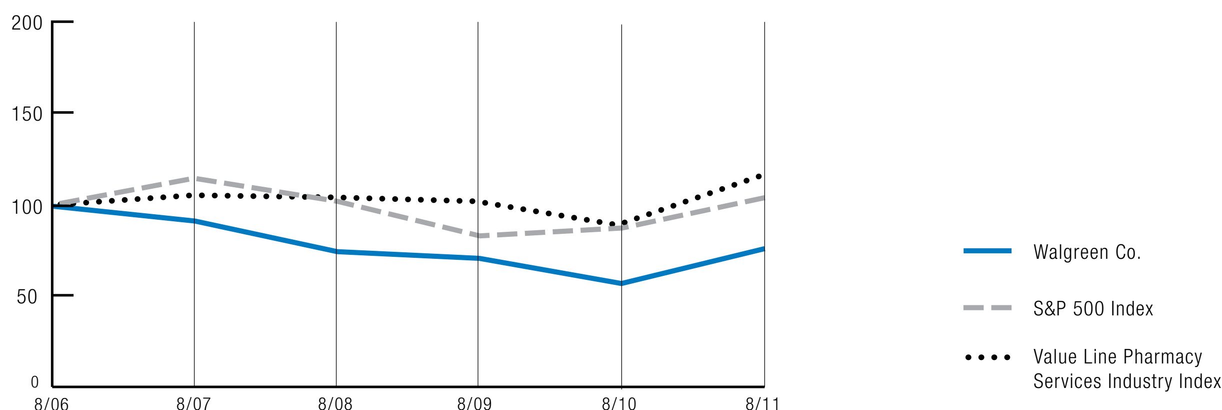
Common Stock Prices

Below is the Consolidated Transaction Reporting System high and low sales price for each quarter of fiscal 2011 and 2010.

		Quarter Ended				
		November	February	May	August	Fiscal Year
Fiscal 2011	High	**$35.27**	**$42.91**	**$44.67**	**$44.91**	**$44.91**
	Low	**27.17**	**35.17**	**38.82**	**34.11**	**27.17**
Fiscal 2010	High	$40.37	$39.37	$37.83	$32.82	$40.37
	Low	33.55	33.29	31.92	26.36	26.36

Comparison of Five-Year Cumulative Total Return

The following graph compares the five-year cumulative total return of the Company's common stock with the S&P 500 Index and the Value Line Pharmacy Services Industry Index. The graph assumes a $100 investment made August 31, 2006, and the reinvestment of all dividends. The historical performance of the Company's common stock is not necessarily indicative of future stock performance.



	Value of Investment at August 31,					
	2006	2007	2008	2009	2010	**2011**
Walgreen Co.	$100.00	$ 91.80	$ 75.01	$ 70.95	$57.29	**$ 76.50**
S&P 500 Index	100.00	115.13	102.31	83.63	87.74	**103.97**
Value Line Pharmacy Services Industry Index	100.00	105.54	104.80	102.09	89.34	**115.93**

This performance graph and accompanying disclosure is not soliciting material, is not deemed filed with the SEC, and is not incorporated by reference in any of the Company's filings under the Securities Act or the Exchange Act, irrespective of the timing of and any general incorporation language in such filing.

Management's Report on Internal Control

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation, management concluded that our internal control over financial reporting was effective as of August 31, 2011. Deloitte & Touche LLP, the Company's independent registered public accounting firm, has audited our internal control over financial reporting, as stated in its report which is included herein.

Gregory D. Wasson
President and Chief Executive Officer

Wade D. Miquelon
Executive Vice President and
Chief Financial Officer

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Walgreen Co.:
We have audited the accompanying consolidated balance sheets of Walgreen Co. and Subsidiaries (the "Company") as of August 31, 2011 and 2010, and the related consolidated statements of earnings, shareholders' equity, and cash flows for each of the three years in the period ended August 31, 2011. We also have audited the Company's internal control over financial reporting as of August 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Walgreen Co. and Subsidiaries as of August 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended August 31, 2011, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of August 31, 2011, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

DELOITTE & TOUCHE LLP

Chicago, Illinois
October 25, 2011

For Our Shareholders

Corporate Headquarters
Walgreen Co.
108 Wilmot Road
Deerfield, Illinois 60015
(847) 315-2500

Stock Market Listings
New York Stock Exchange
The NASDAQ Stock Market LLC
Chicago Stock Exchange
Symbol: WAG

Investor Contacts
Rick J. Hans, CFA
Divisional Vice President of
Investor Relations & Finance
(847) 315-2385
rick.hans@walgreens.com

Lisa Meers, CFA
Manager of Investor Relations
(847) 315-2361
lisa.meers@walgreens.com

Annual Shareholders' Meeting
You are cordially invited to attend the meeting to be held Wednesday, January 11, 2012, at 2 p.m. CST, in the Grand Ballroom, Navy Pier, Chicago, Illinois. Formal notice of the meeting, with proxy card and proxy statement, was sent to all shareholders of record as of November 14, 2011.

Investor Information
As of September 30, 2011, Walgreens had 84,643 shareholders of record.

Investor information is available at http://investor.walgreens.com. This includes corporate governance guidelines, charters of all committees of the Board of Directors, quarterly reports, press releases, proxy statements, the Company's Code of Ethics for Financial Executives, Code of Business Conduct and the 2011 Annual Report. These and other reports may also be obtained without charge upon request to:

Shareholder Relations
Walgreen Co. — Mail Stop #1833
108 Wilmot Road
Deerfield, Illinois 60015
(847) 315-2922
http://investor.walgreens.com/InvestorKit.cfm

Walgreens has provided certifications by the Chief Executive Officer and Chief Financial Officer regarding the quality of the Company's public disclosure, as required by Section 302 of the Sarbanes-Oxley Act, on Exhibit 31 to its Annual Report on Form 10-K. Our Chief Executive Officer made an unqualified certification to the New York Stock Exchange with respect to our compliance with NYSE corporate governance listing standards in January 2011.

Electronic Reports
To receive proxy statements, annual reports and related materials electronically, refer to the proxy statement sent to shareholders with this annual report. After January 11, 2012, call Nicholas Zangler at (847) 315-2636 or go to http://investor.walgreens.com/InvestorKit.cfm to request electronic delivery.

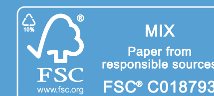
Quarterly Reporting Dates
Quarterly earnings release dates for fiscal 2012 are December 21, March 27, June 26 and September 28. Results are released to the press and posted on the Walgreen website at http://investor.walgreens.com.

Dividend Payment Dates
Walgreens pays dividends in March, June, September and December. Checks are customarily mailed on the 12th of each of these months.

Transfer Agent and Registrar
For assistance on matters such as lost shares or name changes on shares, please contact:

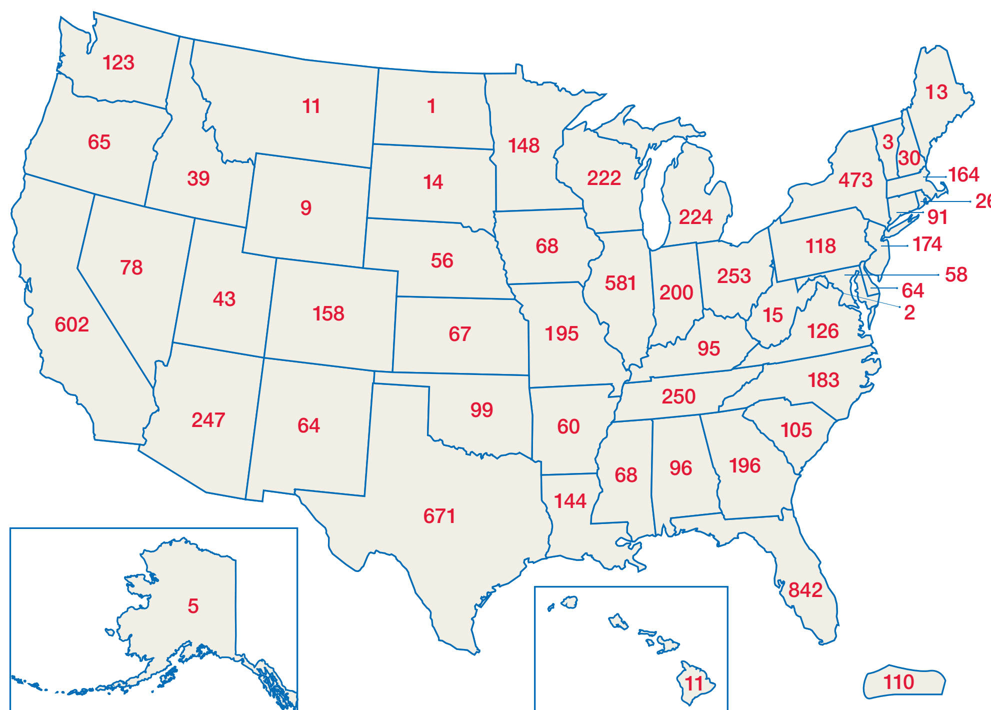
Wells Fargo Bank, N.A.
Shareowner Services
161 North Concord Exchange Street
South Saint Paul, MN 55075-1139
www.wellsfargo.com/shareownerservices
(888) 368-7346

Direct Stock Purchase Plan
Wells Fargo Shareowner Services sponsors and administers a direct stock purchase plan as a convenient method of acquiring Walgreen stock by cash payments, reinvestment of dividends or both. For an information booklet and enrollment form, please call (888) 368-7346. General inquiries to Wells Fargo Bank, N.A. regarding your Walgreen stock should also be directed to (888) 368-7346.



Design: Cagney + Associates, Inc. Major Photography: Michael Mauney

Walgreens Stores Nationwide



Walgreens Additional Points of Care *(as of August 31, 2011)*:

Infusion and respiratory services facilities	83
Mail-order facilities	2
On-site pharmacies in hospitals and medical centers	137
Specialty pharmacies	9
Take Care Clinics	357
Worksite health and wellness centers	355

As part of the Company's commitment to sustainability, this Oxford, Ohio, store is one of 53 Ohio locations installing solar panels on its roof. Walgreens started installing rooftop solar panels on stores and distribution centers in 2007 and now has nearly 120 active systems across the country. Rooftop solar power systems on average provide 15 to 20 percent of the power at specially equipped Walgreen stores.

Giovanni Verde, store team lead in Chicago, joined Walgreens this year through a state-run program designed to help adults find employment. "In less than a year, Giovanni has proven to be a valuable member of our team," says Donald Via, the store manager who hired him. As the Company created 3,000 new jobs in 2011, it also began its "Well Cared For" initiative to strengthen employee engagement by setting new performance standards, providing training and developing leadership skills.

Every day | Building for sustainability

Showcasing the Company's commitment to the environment, this eco-friendly store in Oak Park, Illinois, features the first geothermal energy system in a retail chain in the country. The system, which harnesses the heat from the ground, has reduced the store's expected energy usage by 60 percent. Other green features in this store include a dimming system for sales floor lighting when natural sunlight is available, polished concrete floors made from recycled materials and LED energy-efficient light bulbs used in coolers and for ceiling accent lighting.

With plans to offer electric vehicle charging stations at approximately 800 locations across the country by the end of calendar year 2011, Walgreens will position itself as the retailer with the largest number of these stations in the nation. The Company's neighborhood stores will provide convenient locations for drivers to recharge their electric vehicles near home or work. The charging stations will feature either high-speed direct current chargers that can add 30 miles of range in as little as 10 minutes, or Level 2 chargers that can add up to 25 miles of range per hour of charge.

Walgreens

Walgreen Co.
108 Wilmot Road, Deerfield, Illinois 60015

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